Supreme Court, U.S.
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In The

Supreme Court of the United States

MILWAUKEE SAFEGUARD INSURANCE COMPANY, et al.,

Petitioners,

v.

STEPHEN F. SELCKE, Director of the Illinois Department of Insurance, et al.,

Respondents.

On Petition For Writ Of Certiorari To The Appellate Court Of Illinois, First Judicial District

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Department of Business Regulation*, 496 U.S. 18 (1990) ("*McKesson*"), this Court unanimously rejected the premise that equitable considerations could justify a State's attempt to avoid paying refunds of an unconstitutionally discriminatory tax, holding that an unconstitutionally discriminatory tax deprives a business taxpayer of property regardless of whether the business passed on the tax to its customers. In light of this holding, the questions presented are:

1. Does the federal Due Process Clause, as applied in *McKesson*, require a State to refund protested payments of an unconstitutionally discriminatory tax regardless of whether the business taxpayer passed on the tax?

2. Does requiring a business taxpayer to prove that it did not pass on an unconstitutionally discriminatory tax impose such theoretical, factual and practical difficulties as to deprive the taxpayer of a "clear and certain remedy" in violation of the minimum requirements of federal Due Process recognized in *McKesson*?

LIST OF PARTIES

The Petitioners are as follows:

Albany Insurance Company
Alpha Property and Casualty Insurance Company
American Continental Insurance Company
American Continental Life Insurance Company
American Family Mutual Insurance Company
American Standard Insurance Company of Wisconsin
Atlas Assurance Company of America
Auto-Owners Insurance Company
The Automobile Insurance Company of Hartford, Connecticut
The Charter Oak Fire Insurance Company
Church Mutual Insurance Company
CIM Insurance Corporation
CUMIS Insurance Society, Inc.
CUNA Mutual Insurance Society
Dairyland Insurance Company
Employers Insurance of Wausau A Mutual Company
Farmington Casualty Company
Fortis Insurance Company
Graphic Arts Mutual Insurance Company
Liberty Insurance Corporation
Liberty Life Assurance Corporation of Boston
Liberty Mutual Insurance Company
Liberty Mutual Fire Insurance Company
MIC General Insurance Corporation
MIC Life Insurance Corporation
MIC Property and Casualty Insurance Corporation
Milwaukee Casualty Insurance Company
Milwaukee Mutual Insurance Company
Milwaukee Safeguard Insurance Company
Mortgage Guaranty Insurance Corporation
Motors Insurance Corporation
Mutual Service Casualty Insurance Company

LIST OF PARTIES – Continued

National American Insurance Company
National Casualty Company
National General Insurance Company
Nationwide General Insurance Company
Nationwide Life Insurance Company
Nationwide Mutual Fire Insurance Company
Nationwide Mutual Insurance Co.
Nationwide Property & Casualty Insurance Company
Northwestern National Casualty Company
Owners Insurance Company
The Phoenix Insurance Company
Sentry Insurance A Mutual Company
Sentry Life Insurance Company
The Standard Fire Insurance Company
Travelers Casualty & Surety Company
Travelers Casualty & Surety Company of America
Travelers Casualty Company of Connecticut
Travelers Commercial Insurance Company
The Travelers Home and Marine Insurance Company
The Travelers Indemnity Company
The Travelers Indemnity Company of Connecticut
The Travelers Life and Annuity Company
Utica Mutual Insurance Company
VASA North Atlantic Insurance Company
(now known as Centris Insurance Company)
Wausau Underwriters Insurance Co.
West Bend Mutual Insurance Company
Wisconsin Mortgage Assurance Corporation
(now known as MGIC Indemnity Corporation)

The Respondents are as follows:

Stephen F. Selcke, in his official capacity as Director of the Illinois Department of Insurance at the time certain of Petitioners' complaints were filed.

LIST OF PARTIES – Continued

James W. Schacht, in his official capacity as Acting Director of the Illinois Department of Insurance at the time certain of Petitioners' complaints were filed.

Mark Boozell, in his official capacity as Director of the Illinois Department of Insurance at the time certain of Petitioners' complaints were filed.

Patrick Quinn, in his official capacity as Treasurer of the State of Illinois at the time certain of Petitioners' complaints were filed.

Judy Baar-Topinka, in her official capacity as Treasurer of the State of Illinois at the time certain of Petitioners' complaints were filed.

The Illinois Department of Insurance.

The companies listed below were also parties to the proceeding in the Appellate Court:

American Economy Insurance Company
American States Insurance Company
American States Life Insurance Company
American States Preferred Insurance Company
Employers Health Insurance Company
Pharmacists Mutual Insurance Companies

RULE 29.6 STATEMENTS

The disclosure statements required by Supreme Court Rule 29.6 are contained in the Appendix on pages 69 to 74.

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PETITION FOR WRIT OF CERTIORARI

Petitioners Milwaukee Safeguard Insurance Company, et al. ("Petitioners") respectfully request this Court to issue a writ of certiorari to review the opinion and judgment of the Appellate Court of Illinois, First Judicial District (the "Appellate Court") denying Petitioners' rights under the Due Process Clause of the Fourteenth Amendment to the United States Constitution (the "Due Process Clause" or "Due Process") by holding that, before the State of Illinois may refund Petitioners' protested payments of an unconstitutionally discriminatory tax, Petitioners must first prove that they did not pass on the tax to customers.

OPINIONS BELOW

The order of the Illinois Supreme Court declining review is reported at 197 Ill. 2d 565, ___ N.E.2d ___ (2001), and is set forth at App. 68. The opinion of the Appellate Court is reported at 324 Ill. App. 3d 344, 754 N.E.2d 349 (2001), and is set forth at App. 1-18. The order of the Circuit Court of Cook County, Illinois (the "Circuit Court") is unpublished and is set forth at App. 23-24.

The 1997 opinion of the Illinois Supreme Court declaring the tax at issue in this case to be unconstitutionally discriminatory is reported as *Milwaukee Safeguard Insurance Co. v. Selcke*, 179 Ill. 2d 94, 688 N.E.2d 68 (1997) (*"Milwaukee Safeguard"*), and is set forth at App. 25-54. The Circuit Court's 1996 opinion declaring the tax unconstitutional is unreported, and is set forth at App. 55-66.

JURISDICTION

The Appellate Court issued its opinion on July 17, 2001, holding that the State of Illinois did not violate the federal Due Process Clause by requiring Petitioners to

prove that they had not passed on to customers an unconstitutionally discriminatory tax in order to obtain refunds of their protested payments of the tax. Petitioners timely filed a motion for rehearing and a motion requesting that the Appellate Court certify the issue as sufficiently important that the Illinois Supreme Court must review their decision. The Appellate Court denied these motions on August 27, 2001 and August 16, 2001 respectively. App. 19-22.

Petitioners then filed a motion urging the Illinois Supreme Court to exercise its supervisory authority to summarily reverse the Appellate Court's decision. The Illinois Supreme Court denied the motion. Petitioners also filed a timely petition for leave to appeal to the Illinois Supreme Court. The Illinois Supreme Court denied the petition on December 5, 2001. App. 68. The jurisdiction of this Court is properly invoked under 28 U.S.C. § 1257.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The Fourteenth Amendment to the United States Constitution provides in relevant part:

> No State shall . . . deprive any person of life, liberty, or property, without due process of law.

U.S. CONST. amend. XIV, § 1.

STATEMENT OF THE CASE

1. Petitioners Challenged The Privilege Tax As Unconstitutionally Discriminatory

Petitioners are insurance companies domiciled in states other than Illinois (*i.e.*, "foreign insurers"). Beginning in 1993, Petitioners filed lawsuits challenging the Illinois tax formerly imposed on foreign insurers based

on their Illinois "net taxable premium income" by Section 409 of the Illinois Insurance Code (the "Privilege Tax").[1]

Petitioners argued that the Privilege Tax was unconstitutionally discriminatory on its face because it was imposed only on foreign insurers, while companies domiciled in Illinois ("domestic" insurers) were exempt. Petitioners asserted that the Privilege Tax discriminated against foreign insurers in violation of the state and federal constitutions.

Petitioners' lawsuits were filed pursuant to the Illinois Protest Act,[2] naming the Director of the Illinois Department of Insurance and the Treasurer of the State of Illinois as defendants. Pursuant to the requirements of the Protest Act, Petitioners paid the Privilege Tax to the State under protest while pursuing their challenge to the tax. Petitioners' payments of Privilege Tax for the period 1993-1997 have been segregated from the Illinois General Revenue Fund and maintained by the State in a separate fund (the "Protest Fund") pending resolution of this litigation. The Protest Fund balance exceeds $100 million.

2. The Illinois Supreme Court Held That The Privilege Tax Is Unconstitutionally Discriminatory

In 1996, the Circuit Court ruled that the Privilege Tax violated both Article IX, section 2 of the Illinois Constitution of 1970 (the "Uniformity Clause") and the Equal

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[1] Prior to 1998, the Privilege Tax was imposed by 215 ILL. COMP. STAT. 5/409 (2001). As discussed in more detail below, after the Illinois Supreme Court's decision invalidating the tax in *Milwaukee Safeguard*, the State of Illinois replaced the Privilege Tax with a nondiscriminatory tax on all insurers, whether foreign or domestic.

[2] The "Protest Act" is the common name for the State Officers and Employees Money Disposition Act, 30 ILL. COMP. STAT. 230/1 (2001) *et seq.*

Protection Clauses of the Illinois and United States Constitutions (the "Equal Protection Clauses"). 1970 Ill. Const. Art. I, § 2; Art. IX, § 2.

In 1997, on direct appeal, the Illinois Supreme Court affirmed the Circuit Court's decision that the Privilege Tax was unconstitutional because it violated the Uniformity Clause. *Milwaukee Safeguard*, 179 Ill. 2d 94, 688 N.E.2d 68 (1997). The Illinois Supreme Court did not reach the Circuit Court's ruling that the Privilege Tax also violated the state and federal Equal Protection Clauses.

In 1998, after the Illinois Supreme Court's decision became final, the Illinois legislature repealed the discriminatory Privilege Tax and enacted a new, nondiscriminatory tax on both foreign and domestic insurers doing business in Illinois. *See* 1998 Ill. Legis. Serv. 90-583 (West). However, Illinois made no effort to cure the discrimination of the Privilege Tax for past periods by imposing a retroactive tax on the formerly favored class of domestic insurers.

3. On Remand, Respondents Raised The Pass-On Defense For The First Time

The Illinois Supreme Court remanded the case to the Circuit Court for further proceedings consistent with its *Milwaukee Safeguard* opinion. In June 1999, the Circuit Court granted summary judgment to Petitioners on the remaining count of their complaints, holding that the State could not offset Petitioners' refunds of the Privilege Tax by imposing on Petitioners a separate, alternative tax.

In March 2000, Respondents argued for the first time that the State need not refund Petitioners' protested Privilege Tax payments unless Petitioners first prove that they did not pass on the Privilege Tax to their customers (the "pass-on defense"). Respondents further asserted that Petitioners bear the burden of proving that they did not pass on the tax to customers. Respondents urged the Circuit Court to proceed immediately with discovery and

trials on the issue whether each of the 59 separate Petitioners passed on the unconstitutional Privilege Tax to customers.

In response, Petitioners argued that federal Due Process principles applied in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Department of Business Regulation*, 496 U.S. 18 (1990) bar the pass-on defense as a matter of federal constitutional law. In June 2000, the Circuit Court rejected Petitioners' federal Due Process argument, and ruled that Petitioners must prove that they did not pass on the Privilege Tax to their customers before they may recover their protested tax payments. Because a reversal of the Circuit Court's ruling would eliminate the need for cumbersome discovery and trials for each of the 59 separate Petitioners, the Circuit Court certified the issue for an immediate appeal to the Appellate Court.

4. The Appellate Court Held That Petitioners Must Defeat The Pass-On Defense As A Precondition To Refunds

The Appellate Court rejected Petitioners' argument that federal Due Process principles applied in *McKesson* bar the pass-on defense as a matter of federal constitutional law. The Appellate Court affirmed the order of the Circuit Court, and denied rehearing. On December 5, 2001, the Illinois Supreme Court denied Petitioners' timely petition for leave to appeal.

The next day, on December 6, 2001, Respondents served substantial discovery requests seeking information from each of the 59 Petitioners relating to the pass-on defense. Petitioners filed a motion for stay in the Illinois Supreme Court, asking the court to stay issuance of its mandate (and therefore, to stay proceedings in the Circuit Court) pending the outcome of this Petition for Writ of Certiorari (the "Petition"). The Illinois Supreme Court denied Petitioners' motion for stay on January 16, 2002. App. 67.

As a result of the Illinois Supreme Court's denial of Petitioners' request for a stay, proceedings in the Circuit Court on this issue are now underway. A reversal of the Appellate Court's decision would preclude any further litigation on this issue, entirely eliminating the need for the proceedings currently underway in the Circuit Court.[3]

However, without this Court's immediate intervention, the litigation will proceed, and each of the 59 Petitioners will be required to respond to burdensome and irrelevant discovery and proceed with a trial at which each company will bear the burden of proving that it did not pass on the Privilege Tax to its customers.

REASONS FOR GRANTING THE PETITION

I. Introduction

This Court should grant the Petition to enforce and protect the right of business taxpayers to obtain a clear and certain remedy for an unconstitutionally discriminatory tax. In *McKesson*, this Court unanimously held that federal Due Process bars a State from denying a business taxpayer a clear and certain remedy for payment of an unconstitutionally discriminatory tax on the basis that the taxpayer somehow may have passed on the tax to its customers. In so holding, this Court recognized that a business taxpayer required to pay a discriminatory tax is deprived of property *regardless* of whether the tax has been passed on to customers. In the twelve years since *McKesson*, this Court has reinforced this ruling, holding that to require a taxpayer to defeat the pass-on defense in order to obtain a refund of a discriminatory tax violates

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[3] Further proceedings in the Circuit Court may be required on a different issue, because Respondents filed a motion for reconsideration of the Circuit Court's ruling in favor of Petitioners on the alternative tax offset issue, a motion which the Circuit Court has had under advisement since briefing and argument were completed more than 2 years ago.

the "minimum federal requirements" of Due Process. *See, e.g., Harper v. Virginia Dep't of Taxation*, 509 U.S. 86 (1993).

This case has broad implications for business taxpayers and courts nationwide. Absent review by this Court, states will be emboldened to require business taxpayers to prove that they did not pass on the cost of any unconstitutionally discriminatory tax in order to obtain a refund. Permitting states to impose the pass-on defense will discourage business taxpayers from challenging unconstitutionally discriminatory taxes, creating the possibility that such taxes will remain in force despite their unconstitutionality, and providing an incentive for further unconstitutional discrimination. Accordingly, the protections of the federal Due Process Clause stand in danger of serious erosion. This Court should therefore grant certiorari and reverse the decision below, sending a necessary message that the federal Due Process Clause bars the pass-on defense in the context of a discriminatory tax.

Furthermore, this Court has expressed heightened concern about the theoretical, factual and practical difficulties inherent in the pass-on defense, and has consistently expressed doubt that the economic incidence of discriminatory state taxes may ever be accurately determined by a court. While this Court has more fully addressed the burdens this defense poses on the assertion of statutory rights under the federal antitrust laws (*see Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481 (1968), *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977)), the Court's analysis in *McKesson* indicates that the burden is even more troublesome where, as here, the pass-on defense would encumber a taxpayer's federal constitutional right to a "clear and certain remedy." Conditioning a successful challenger's refund of a discriminatory state tax on such an arbitrary and unworkable process creates a remedy so burdened as to be meaningless, in violation of the federal Due Process Clause.

Finally, without this Court's immediate intervention, the fundamental protections of Due Process necessary to ensure a clear and certain remedy will be seriously undermined. The Petitioners here will be deprived of Due Process, because, at a minimum, each will be required to undergo extensive additional litigation, including costly, burdensome and irrelevant discovery and then complex trials, all to defeat a defense that this Court has unanimously forbidden as a matter of federal constitutional law.

II. The Court Should Enforce And Protect The Due Process Right To A Clear And Certain Remedy Recognized In Its Unanimous Decision In *McKesson*

A. Due Process Requires A "Clear And Certain Remedy"

It is well settled that Due Process generally prevents a State from depriving a citizen of property without the opportunity for a hearing *prior* to the deprivation. *See, e.g., Mathews v. Eldridge*, 424 U.S. 319 (1976); *McKesson*, 496 U.S. at 36. A State's collection of taxes provides a narrow exception to this general rule; because of the strong state interest in the orderly collection of tax revenue, states may constitutionally require state taxpayers to pay disputed taxes prior to challenging them. *See, e.g., Bob Jones Univ. v. Simon*, 416 U.S. 725 (1974); *see also McKesson*, 496 U.S. at 37 n.18.

However, when a State chooses to limit taxpayers to a post-payment proceeding, Due Process imposes certain obligations on that State. This Court established almost a century ago that where a State has imposed an unlawful tax, it has deprived the taxpayer of property and must provide a clear and certain remedy for the deprivation. *Atchison, Topeka & Santa Fe Ry. Co. v. O'Connor*, 223 U.S. 280 (1912); *see also Ward v. Bd. of County Comm'rs*, 253 U.S. 17 (1920); *Carpenter v. Shaw*, 280 U.S. 363, 369 (1930); *Iowa-Des Moines Nat'l Bank v. Bennett*, 284 U.S. 239, 247 (1931). As this Court held in *Ward v. Bd. of County Comm'rs:*

> To say that the [taxing authority] could collect these unlawful taxes by coercive means and not incur any obligation to pay them back is nothing short of saying that it could take . . . property . . . arbitrarily and without due process of law. Of course this would be in contravention of the Fourteenth Amendment.

253 U.S. at 24.

In 1984, in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), this Court began to explain why requiring a business taxpayer to prove that it has not passed on a discriminatory state tax to customers is inconsistent with a clear and certain remedy. As this Court properly noted, "even if [a] tax is completely and successfully passed on, it increases the price of [the disfavored business'] products as compared to the exempted [products] . . . ." *Id.* at 267. Nonetheless, even after *Bacchus*, states continued to force business taxpayers to defeat the pass-on defense as a precondition to recovering unconstitutionally discriminatory taxes paid. Thus, six years after *Bacchus*, in *McKesson*, this Court explained in even stronger terms why the pass-on defense does not apply in the context of a discriminatory tax.

In *McKesson*, this Court unanimously held that where a State has deprived taxpayers of property by requiring them to pay a disputed tax prior to challenging it, Due Process requires the State to provide "meaningful backward-looking relief." *McKesson*, 496 U.S. at 31.[4] In the context of a discriminatory tax, *McKesson* holds that a State is obligated to cure the past tax discrimination either by (1) refunding the discriminatory tax to the members of the disfavored class, (2) retroactively assessing and collecting taxes from the favored class, or (3)

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[4] Here, it is undisputed that the State of Illinois did not offer Petitioners an adequate pre-deprivation procedure for challenging the Privilege Tax.

some combination of (1) and (2). 496 U.S. at 40-41.[5] Where, however, a State fails to provide a taxpayer with this "clear and certain remedy" for the State's unlawful deprivation of the taxpayer's property, the State has failed to afford the taxpayer the minimum requirements of federal Due Process. *Id.*

Now 12 years after *McKesson*, however, states are still refusing to follow the requirements of Due Process and the holding of *McKesson*. State courts are still requiring business taxpayers to defeat the pass-on defense as a condition to recovering unconstitutionally discriminatory taxes, necessitating intervention by this Court once again. This Court should grant the Petition and reverse the decision below, to prohibit, once and for all, a State's use of the pass-on defense as a barrier to the refund of an unconstitutionally discriminatory tax.

B. Due Process Bars The Pass-On Defense In The Context Of A Discriminatory Tax

In *McKesson*, this Court unanimously ruled that the federal Due Process Clause requires a State to refund an unconstitutionally discriminatory tax whether or not the taxpayer passed on the tax to customers. The decision below cannot be reconciled with this Court's ruling in *McKesson*. This Court should grant the Petition to ensure that business taxpayers forced to pay unconstitutionally discriminatory taxes receive the minimum requirements of Due Process, and to prevent the serious erosion of the fundamental protections of Due Process recognized in *McKesson*.

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[5] Because the State of Illinois has made no attempt to enact a retroactive tax on the favored class, the State could satisfy *McKesson* only by providing meaningful backward looking relief in the form of refunds of Petitioners' protested tax payments.

In *McKesson*, a group of wholesale liquor distributors sued the State of Florida challenging a Florida excise tax on alcoholic beverages that discriminated against beverages made from agricultural products generally grown outside Florida. The plaintiff distributors sought injunctive relief and requested refunds of the tax. The trial court held that the tax unconstitutionally discriminated against interstate commerce, but refused to award the plaintiffs a refund. The Florida Supreme Court affirmed, speculating that "if given a refund, [petitioners] would in all probability receive a windfall, since the cost of the tax has likely been passed on to [their] customers." 496 U.S. at 46.

After granting certiorari, this Court reversed, noting that:

> [The Florida Supreme Court's] premise seems to be that the State, faced with an obligation to cure its discrimination during the contested tax period and choosing to meet that obligation through a refund, could legitimately choose to avoid generating a "windfall" for petitioner by refunding only that portion of the tax payment not "passed on" to customers.

Id. The Court unanimously rejected the premise of this windfall or pass-on defense argument, stating: "we reject respondents' premise that 'equitable considerations' justify a State's attempt to avoid bestowing this so-called 'windfall' when redressing a tax that is unconstitutional because discriminatory." *Id.* at 47.

The Court held that it was irrelevant whether the plaintiff distributor had passed on the tax:

> [T]he tax injured petitioner not only because it left petitioner poorer in an absolute sense than before (a problem that might be rectified to the extent petitioner passed on the economic incidence of the tax to others), but also because it placed petitioner at a relative disadvantage in

> the marketplace vis-à-vis competitors distributing [untaxed] products. To whatever extent petitioner succeeded in passing on the economic incidence of the tax through higher prices to its customers, it most likely lost sales to the favored distributors or else incurred other costs (*e.g.*, for advertising) in an effort to maintain its market share. *The State cannot persuasively claim that "equity" entitles it to retain tax moneys taken unlawfully from petitioner due to its pass-on of the tax where the pass-on itself furthers the very competitive disadvantage constituting the [constitutional] violation that rendered the deprivation unlawful in the first place.*

McKesson, 496 U.S. at 48-49 (emphasis supplied) (citations omitted).

Thus, the *McKesson* Court explicitly recognized that the unlawful purpose, and resulting harm, of discriminatory taxation is that it provides the favored class with an improper advantage over the disfavored class. Here, foreign insurers burdened by the discriminatory Privilege Tax either would have sold the same insurance at higher prices than domestic insurers, losing customers and market share (to the extent they could pass on the tax), or they would have sold the same insurance at the same price as domestic insurers and made relatively less after-tax profit than domestic insurers (to the extent they could not pass on the tax). Either way, Petitioners were deprived of property by the State of Illinois' unconstitutionally discriminatory Privilege Tax. In rejecting the pass-on defense in the context of discriminatory taxes, this Court ruled that a business taxpayer subject to a discriminatory tax has been deprived of property *regardless* of whether the tax was passed on to customers.

This Court has consistently reaffirmed that *McKesson's* rejection of the pass-on defense in the context of a discriminatory tax is one of the "minimum federal requirements" of Due Process. *See, e.g., Harper v. Virginia*

Dep't of Taxation, 509 U.S. 86, 102 (1993). State courts are generally given the "initial duty" of crafting relief for unconstitutionally discriminatory state taxes (*McKesson*, 496 U.S. at 32 n.16), because state law may provide more relief than federal Due Process requires. *See, e.g., Bacchus*, 468 U.S. at 277 n.14 ("It may be, for example, that given an unconstitutional discrimination, a full refund is mandated by state law."). However, this Court has held that in crafting relief for unconstitutionally discriminatory taxes, state courts must accord taxpayers certain basic federal Due Process protections, and may not treat their initial duty to craft remedies as an invitation to ignore the minimum requirements of federal Due Process.

Rather, Due Process must be treated as a "floor" below which a State's proffered remedy may not fall. For example, in *James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529 (1991), Justices Souter and Stevens recognized that, although the question of remedy is one of state law, the remedy chosen by a State is "[s]ubject to possible constitutional thresholds," citing *McKesson*.[6] 501 U.S. at 535. Similarly, in *Harper, supra*, the Court noted that a State could choose to grant broader relief than required by Due Process, but mandated that "*under no circumstances may it confine petitioners to a lesser remedy*," citing the very pages of *McKesson* that discussed and rejected the pass-on defense. 509 U.S. at 102 (emphasis added).

C. *McKesson* Allows No Exception

The decision below attempted to distinguish *McKesson* on erroneous and unworkable grounds, limiting *McKesson* to circumstances where state law makes a mere "passing reference" to equitable considerations. App. 11. The Appellate Court stated that "unlike the defendants in *McKesson*, [Respondents] here have cited

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[6] *Beam* inspired five separate opinions, none of which was joined by more than three Justices.

an Illinois Supreme Court case that supports the use of a nonstatutory pass-on defense in a discriminatory tax case." App. 13, citing *Consolidated Distilled Prods., Inc. v. Mahin*, 56 Ill. 2d 110, 306 N.E.2d 465 (1973).[7] Under the Appellate Court's rationale, any State with pre-*McKesson* case law applying an equity-based pass-on defense would essentially be "grandfathered" and exempt from the constitutional mandate of *McKesson*. Federal Due Process would require one thing in one State, and something less in another State, leading to a balkanization of what should be a uniform federal constitutional standard.[8]

This Court specifically rejected this argument in *McKesson* itself. The State of Florida likewise argued that Florida common law contained an equitable prohibition on unjust enrichment, embodied in a 1973 Florida Supreme Court case called *State ex rel. Szabo Food Services, Inc. v. Dickinson*, 286 So. 2d 529 (Fla. 1973). *McKesson*, 496 U.S. at 49 n.34. The Florida Supreme Court in *Szabo* had refused on equitable grounds to hear a challenge to a

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[7] The Appellate Court appears to be suggesting a notice-based concept of Due Process, implying that where a taxpayer is able to discern from state common law a principle against unjust enrichment, sufficient "notice" has been provided to the taxpayer to satisfy the requirements of Due Process. The requirement of a "clear and certain remedy," however, is based on the State's failure to provide an adequate pre-payment procedure for challenging a tax, irrespective of whether the taxpayer has received notice. Because the State has deprived a taxpayer of property by relegating it to a post-deprivation procedure for challenging a tax, Due Process requires the State to undo its discrimination.

[8] This Court has permitted the pass-on defense only in the context of nondiscriminatory taxes. *See, e.g., United States v. Jefferson Elec. Mfg. Co.*, 291 U.S. 386 (1934) (nondiscriminatory tax on all manufacturers of auto parts). Unlike here, in the context of a nondiscriminatory tax all taxpayers are subject to the tax, and no taxpayer is competitively disadvantaged by the payment of the tax. *See McKesson*, 496 U.S. at 48-49.

state tax, holding that the plaintiff did not have standing to demand a refund of the disputed tax because it had not borne the burden of the tax. *Szabo*, 286 So. 2d at 532. However, this Court in *McKesson* explicitly rejected this argument, holding that the State of Florida could not rely on a pass-on defense rooted in equity in the context of a discriminatory tax. *McKesson*, 496 U.S. at 46-47.[9]

The Appellate Court concluded that in *McKesson*, this Court disagreed with the Florida Supreme Court's application of Florida common law. That is not what this Court did. Indeed, under basic principles of federalism, this Court cannot second-guess the interpretations of state law given by a state's highest court. Florida common law is what the Florida Supreme Court says it is; if the Florida Supreme Court holds that Florida common law provides for a pass-on defense in the context of a discriminatory tax, then Florida law does, in fact, provide such a defense.

This Court's only power is to reverse a state high court on federal grounds. *Herb v. Pitcairn*, 324 U.S. 117, 125-26 (1945) ("Our only power over state judgments is to correct them to the extent that they incorrectly adjudge federal rights."); *see also Murdock v. City of Memphis*, 87 U.S. (20 Wall.) 590 (1874). As the Harvard Law Review's analysis of *McKesson* emphasized:

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[9] *McKesson* did not reach the question whether a state may, by statute, constitutionally limit its waiver of sovereign immunity to situations where a taxpayer has not passed on the tax. 496 U.S. at 49 n.34. That question is not presented here, because the pass-on defense asserted by Respondents is based on equitable considerations, not a statute. In addition, sovereign immunity is not implicated here because Petitioners' challenges were brought pursuant to the Protest Act, which permits suits to recover protested tax payments. *See* 30 ILL. COMP. STAT. 230/2(a) (2001).

> Because the Court lacks appellate jurisdiction over issues of state law, its assertion of jurisdiction implies that federal remedial principles were operating in McKesson's case. The Court's holding, based on the due process clause, makes this explicit. After *McKesson*, state remedial principles do not operate freely in determining the proper relief from an unconstitutional state tax exacted under duress.

Unconstitutional State Taxes – Federal Standard for Remedies in State Court, 104 HARV. L. REV. 188, 193 (1990). This Court's holding in *McKesson* can therefore only be read to reject the pass-on defense on federal Due Process grounds, even if state common law would otherwise allow the defense. As this Court recently affirmed, the State's obligation to provide a clear and certain post-deprivation remedy "arises from the Constitution itself." *Alden v. Maine*, 527 U.S. 706, 740 (1999).

The law is also settled that Petitioners are entitled to the protections of the federal Due Process Clause even though the Privilege Tax was held unconstitutional under the state constitution – a concept even the Appellate Court accepted. The Fourteenth Amendment prevents a State from depriving persons of property without Due Process – regardless of whether the deprivation is challenged in state or federal court and regardless of whether the challenged deprivation violates state or federal law. In *Richards v. Jefferson County*, 517 U.S. 793 (1996), this Court held that denial on state law *res judicata* grounds of a claim for refund of an Alabama tax violated federal Due Process despite the fact that the tax was never invalidated under federal law. 517 U.S. at 804; *see also Brinkerhoff-Faris Trust & Sav. Co. v. Hill*, 281 U.S. 673, 681-82 (1930) (dismissal of challenge to state property tax on state law procedural grounds violated federal Due Process). The

fact that the Privilege Tax was invalidated on state constitutional grounds is simply irrelevant; Petitioners are entitled to a clear and certain remedy for the State of Illinois' unlawful deprivation of their property.

D. This Court Should Grant Certiorari To Prevent A Significant Threat To The Federal Due Process Right To A "Clear and Certain Remedy"

This Court should grant the Petition in order to prevent states from circumventing the protections of the federal Due Process Clause recognized in *McKesson*. If the Appellate Court's decision is not immediately reversed, the decision could encourage tax authorities in any state to avoid paying refunds of unconstitutionally discriminatory state taxes in violation of the minimum requirements of federal Due Process.

The Appellate Court's disregard of *McKesson* leaves taxpayers doing business in Illinois in jeopardy. The Appellate Court's decision is not limited to insurance taxes. Without this Court's intervention, every taxpayer doing business in Illinois could be faced with the difficult task of proving that it did not pass on the cost of any discriminatory business tax to customers.

Without this Court's immediate guidance, courts in other states may well follow Illinois' lead. States may routinely require business taxpayers to defeat pass-on defenses, thereby undermining enforcement of state and federal constitutional protections against discriminatory taxation. *See, e.g., South Cent. Bell Tel. Co. v. Alabama*, 789 So. 2d 147 (Ala. 2000) (requiring information on the extent to which taxpayers passed on to customers a discriminatory tax); *State ex rel. Paige v. Canady*, 189 W. Va. 650, 434 S.E.2d 10 (1993) (ruling that, despite *McKesson*, state may require evidence that discriminatory tax was not passed on to customers). Federal constitutional protections against discrimination such as the Commerce

Clause and the Equal Protection Clause would stand in danger of compromise.[10]

Finally, permitting states to require business taxpayers to defeat the pass-on defense could encourage further discriminatory taxation. Commentators have noted that states are already inclined to look to taxpayers outside their political base for additional revenue in times of fiscal pressure. Professors Fallon and Meltzer argue that "states already have strong political motives to engage in discriminatory taxation, and acceptance of the windfall argument might too far erode the needed, contrary incentives." Richard H. Fallon, Jr. and Daniel J. Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 HARV. L. REV. 1731, 1833 n.569 (1991). They further argue that these incentives are "strong reasons" why courts should not consider whether a tax refund has the "quality of a windfall." *Id.* Similarly, Professor Coverdale argues that:

> Remedies for unconstitutional taxes are needed not only because of the moral imperative of compensating taxpayers whose funds have been taken in violation of the Constitution, but also because of the instrumental need to deter states from exacting unconstitutional taxes in the future.

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[10] The ineffective enforcement of prohibitions on discriminatory taxation could affect a number of federal interests, including the effective protection of interstate commerce and the prevention of taxation of federal instrumentalities. In addition, to the extent that the pass-on defense could deprive non-U.S. companies of the ability to recover unconstitutional taxes, it could create an irritant in the commercial relations of foreign governments with the United States, burdening the conduct of foreign relations. For these reasons, the Court may wish to invite the Solicitor General to state his views with respect to the Petition.

John F. Coverdale, *Remedies for Unconstitutional State Taxes*, 32 CONN. L. REV. 73, 79 (1999).

This Court's immediate enforcement of the Due Process protections applied in *McKesson* will send a necessary message to states that the minimum requirements of Due Process may not be circumvented by so-called "equitable considerations" under state common law. This Court should grant the Petition and reverse the Appellate Court, holding that the rejection of the pass-on defense in the context of a discriminatory tax is one of the minimum requirements of Due Process.

III. Requiring Taxpayers To Overcome The Pass-On Defense Places A Nearly Insuperable Burden On Courts And Business Taxpayers Nationwide

Even without this Court's immediate intervention, it is theoretically possible that Petitioners could ultimately prevail at trial, proving that they bore the economic burden of the unconstitutionally discriminatory Privilege Tax and did not pass the tax on to customers. Such a victory would be hollow, and would come at the cost of constitutional rights. *McKesson* requires that the State of Illinois refund the tax without regard to the pass-on defense, not that the State refund the tax after years of cumbersome and costly litigation over irrelevant issues. Federal Due Process prevents the State of Illinois from requiring Petitioners to overcome the pass-on defense in the first place where the underlying tax is unconstitutionally discriminatory. As *McKesson* demonstrates, in the discriminatory tax context, the pass-on defense is replete with "theoretical, factual and practical difficulties." 496 U.S. at 47 n.31.

Even outside the discriminatory tax context, this Court has expressed particular concern that requiring a business to prove whether a cost has been passed on to customers is an arbitrary and unworkable burden. *See Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481 (1968); *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). As

this Court noted in *McKesson*, each of the concerns expressed by the Court in *Hanover Shoe* and *Illinois Brick* is equally applicable in the context of a discriminatory tax. 496 U.S. at 46-47 nn.30-33.

A. Economic Incidence Analysis Burdens Courts And Taxpayers

In *Hanover Shoe*, this Court indicated that in the antitrust context, addressing the pass-on defense would place a nearly insurmountable burden on courts and litigants. According to the Court, because a wide range of factors influence a company's pricing policies, "the impact of a single change in the relevant conditions cannot be measured after the fact." 392 U.S. at 492. This Court emphasized the virtual impossibility of determining, for example, whether the company would have priced its product differently under different circumstances, what effect a change in price would have had on sales, and so on. *Id.* at 493. Litigation over the facial constitutionality of discriminatory state taxes would become highly complex, requiring expert economists and extensive discovery.[11]

In sum, this Court in *Hanover Shoe* expressed skepticism that the pass-on defense could be proven in any event:

> Since establishing the applicability of the passing-on defense would require a convincing showing of each of these virtually unascertainable

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[11] Protracted proceedings to determine whether the party before the court is the party that "bore the burden" of a tax could prevent courts from promptly reaching the constitutional merits. Thus, ironically, a function courts are ill-equipped to serve could block courts from fulfilling an important function for which courts are uniquely suited – addressing the facial constitutionality of tax statutes.

> figures, the task would normally prove insurmountable.

392 U.S. at 493.

In the tax context, this Court has expressed serious doubt about the ability of courts to determine the economic incidence of a discriminatory tax at all. For example, in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), this Court rejected the State of North Carolina's argument that the intangibles tax and the general corporate income taxes were "compensatory" taxes, rendering the intangibles taxes constitutional under the Commerce Clause. Although the intangibles tax was imposed on shareholders and the income tax was imposed on corporations, the State nonetheless argued that the taxes were functionally equivalent because the burden of the corporate income tax was passed on to corporate shareholders.

The Court detailed the complex analysis that the State would be required to prove, noting that the actual incidence of a tax depends on "elasticities of supply and demand, the ability of producers and consumers to substitute one product for another, the structure of the relevant market, the timeframe over which the tax is imposed and evaluated, and so on." *Fulton*, 516 U.S. at 341. The Court then noted that:

> [C]ourts as institutions are poorly equipped to evaluate with precision the relative burdens of various methods of taxation. The complexities of factual economic proof always present a certain potential for error, and courts have little familiarity with the process of evaluating the relative economic burden of taxes.

Id. at 342 (citing *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 589-90 nn.12-14 (1983)); *see also Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 619 n.8 (1981) (determining where tax burden

falls "would require complex factual inquiries about such issues as elasticity of demand for other alternative sources of supply"); *Indian Motocycle Co. v. United States*, 283 U.S. 570, 581 (1931) (Stone, J., dissenting) ("[W]hether the burden of any tax paid by [a] seller is actually passed on to the buyer depends upon considerations so various and complex as to preclude the assumption *a priori* that any particular tax at any particular time is passed on.").[12]

Determining the economic incidence of the Privilege Tax involves additional difficulties unique to this case, including the following:

- This case involves 59 Petitioners writing a wide variety of insurance coverages. The proof required to defeat the pass-on defense may vary by company and by line of business (e.g., automobile, homeowners, accident & health, life). Even if each Petitioner wrote only three or four of the 45 commonly recognized types of insurance coverage, the parties and the courts could be required to sift through 200 or more separate sets of complex proof.
- The Privilege Tax was not like a sales or use tax added on to the price of the product at the point of sale. Rather, the Privilege Tax was imposed annually, on "net taxable premium income", and credits were permitted against

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[12] Commentators agree. Professors Fallon and Meltzer have described the determination of whether a tax was passed on as a "deeply problematic and treacherous task." 104 HARV. L. REV. at 1833 n.569; *see also* William J. Woodward, Jr., *"Passing-On" the Right to Restitution*, 39 U. MIAMI L. REV. 873, 925-26 (1985) (arguing that an inquiry into whether a tax has been passed on to customers, other than where such tax has been separately collected from customers, is "extraordinarily complicated" and introduces questions of causation and burden of proof).

the Privilege Tax for other taxes and fees paid by Petitioners, such as the Illinois Income Tax. The amount of Privilege Tax purportedly "collected" from any specific customer (if any) is therefore impossible to determine accurately.

- Many of Petitioners' customers are themselves businesses, potentially subject to claims that the Privilege Tax was passed on to *their* customers, *ad infinitum*. Thus, there exists the very real possibility that there will be no party with sufficient proof to recover a substantial portion of the protested Privilege Tax payments.[13]

B. Competitive Information May Not Be Available

This Court in *Hanover Shoe* specifically noted that the impact of competition on price would be nearly impossible to measure. Even if it could be proven that the plaintiff had passed on the amount of the illegal overcharge without sacrificing sales volume:

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[13] Indeed, in December 2001, a Petition for Intervention was filed in the Circuit Court on behalf of two alleged customers of one of the Petitioners, seeking to intervene in the litigation and purporting to represent a class of customers of all Petitioners. Respondents opposed the Petition for Intervention, arguing, *inter alia*, that the potential Intervenors failed to establish that their intervention was timely. If Respondents are correct that Petitioners' customers are time-barred from laying any claim to Petitioners' escrowed payments of the Privilege Tax, and if Petitioners are unable to defeat the pass-on defense, the funds will revert to the State's General Revenue Fund, and the State of Illinois will retain the "fruits of [its] illegality." *See Illinois Brick*, 431 U.S. at 725.

> [T]here would remain the nearly insuperable difficulty of demonstrating that the particular plaintiff could not or would not have raised his prices absent the overcharge or maintained the higher price had the overcharge been discontinued.

392 U.S. at 493. The difficulty of proving the effect of competition in the antitrust context is equally present in the context of a discriminatory tax. Proving whether a business taxpayer passed on the extra cost of a discriminatory tax to customers could require evidence relating to the taxpayer's competitors, including, for example, the price the taxpayer's favored competitors charged for the same product, the profits the favored competitors realized, and whether market conditions would have permitted the taxpayer to charge a price higher than the price charged by the companies not subject to the tax. A significant part of this evidence exists in the files of a taxpayer's competitors, who can be expected to contest sharing competitive pricing information that may constitute trade secrets, and who will not be before the court charged with making this determination.

Here, the favored class of domestic insurers is composed of hundreds of companies that may possess important parts of the proof needed to defeat the pass-on defense, including the companies' pricing, profit and sales information. Those insurers are not party to this case.

C. Permitting The Pass-On Defense Would Have A Chilling Effect On Challenges To Unconstitutionally Discriminatory Taxes

This Court in *Hanover Shoe* also expressed concern that permitting the pass-on defense would complicate statutory antitrust proceedings, thereby reducing their effectiveness. The Court stated:

> [I]t is not unlikely that if the existence of the defense is generally confirmed, antitrust defendants will frequently seek to establish its applicability. Treble-damage actions would often require additional long and complicated proceedings involving massive evidence and complicated theories.

392 U.S. at 493. Similarly, in the state tax context, if states are permitted to apply the pass-on defense to claims for refund of unconstitutionally discriminatory taxes, states will not fail to raise the issue, thus rendering tax challenges largely ineffective.

In fact, the rationale of *Hanover Shoe* is even more compelling in the state tax context. Although numerous state and federal agencies are charged with the enforcement of antitrust laws, taxpayer challenges generally represent the only check on the constitutionality of state tax provisions. Individual customers have little incentive to challenge state taxes imposed on businesses, and may even lack standing to challenge a state tax not legally imposed on them. In the words of this Court in *Illinois Brick*, states imposing unconstitutional taxes "would retain the fruits of their illegality" because individual customers "would have only a tiny stake in the lawsuit and hence little incentive to sue." 431 U.S. at 725-26 (citing *Hanover Shoe*, 392 U.S. at 494) (internal quote

marks omitted).[14] Without taxpayer oversight of the state tax burdens on interstate commerce and out-of-state taxpayers, states will have little incentive to examine the constitutionality of their tax statutes carefully.

This Court should grant the Petition in order to avoid forcing courts and business taxpayers nationwide to undertake the highly complex economic analysis required to address the pass-on defense, and to prevent Respondents from forcing Petitioners to undergo burdensome, costly and ultimately unnecessary discovery and trials. Due Process requires the State of Illinois to afford Petitioners a "clear and certain remedy" for depriving them of their protested payments of Privilege Tax. Requiring Petitioners to defeat the pass-on defense would result in a meaningless and inadequate remedy, in violation of Due Process.

IV. The Issues Presented Are Important And Require This Court's Immediate Attention

Because Petitioners were deprived of property whether or not they passed on the Privilege Tax to customers, review by this Court is warranted at this juncture. The Petition represents the Court's only opportunity to prevent the State of Illinois from violating Petitioners' federal Due Process rights.

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[14] Similarly, Professor Viard argues that permitting the pass-on defense "encourages states to implement tax statutes of doubtful constitutional validity. . . . [N]o consumer is likely to sue to recover his or her portion of the tax, so the state treasury will never [refund] this portion of the tax to anyone." Alan D. Viard, *Pass-On Defense Doesn't Pass Muster*, 52 Tax Notes 1095, 1097 (1991).

If the Petition is denied and the litigation comes before this Court again, Petitioners will already have been subjected to an expensive, protracted and irrelevant inquiry inconsistent with the remedy federal Due Process requires. Petitioners will have been deprived of their tax payments since 1993, and their domestic competitors will have long enjoyed the benefits of higher profits or sales. Despite the interlocutory nature of this appeal, the Court should grant the Petition now.

This case falls squarely within the Court's exceptions to the general "finality" rule of 28 U.S.C. § 1257. In *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975), this Court recognized that a case may be treated as final for jurisdictional purposes where "reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action" and where a refusal to review the state court might "seriously erode federal policy." 420 U.S. at 482-83.[15]

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[15] This Court has also ruled that where subsequent proceedings would deny the federal right the petitioner sought to be protected by this Court's review, the "collateral order" exception to 28 U.S.C. § 1291 is appropriately invoked. *See, e.g., Abney v. United States*, 431 U.S. 651, 662 (1977) (order denying dismissal of indictment was appropriate for review because regardless of the outcome, defendant would have been "forced to endure a trial" that the double jeopardy prohibited); *Helstoski v. Meanor*, 442 U.S. 500, 506-07 (1979) (challenge to indictment appropriately reviewed because Speech or Debate Clause protected Congressmen from the burden of defending themselves); *compare Digital Equip. Corp. v. Desktop Direct, Inc.*, 511 U.S. 863, 877-79 (1994) (contrasting contractual "right to avoid trial" with constitutional or statutory "right to avoid trial"). Similarly, forcing Petitioners to defeat the pass-on defense would violate their federal rights to Due Process, such that immediate review by this Court is appropriate.

The Petition presents just that circumstance. Absent review by this Court now, Petitioners will be forced to undertake burdensome, costly and unnecessary discovery and trials for each of the 59 separate Petitioners. If the Court grants the Petition and reverses the Appellate Court, no further litigation on the pass-on defense will be required. Moreover, as discussed in detail above, if the Appellate Court's decision stands, it will seriously erode the constitutional requirement of a "clear and certain remedy," and will serve as a roadmap for other states to easily avoid the requirements of federal Due Process. For all of these reasons, this Court should grant the Petition to address the important questions presented in this case.

CONCLUSION

The petition for a writ of certiorari should be granted. In view of the conflict of the Appellate Court's decision with *McKesson* and other decisions of this Court, the Court may wish to consider summary reversal.

Respectfully submitted,

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754 N.E.2d 349

Appellate Court of Illinois
First District, Second Division.

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Royal MacCabees Life Insurance Company, Motors Insurance Corporation, CIM Insurance Corporation, MIC Property and Casualty Insurance Corporation, MIC Life Insurance Corporation, MIC General Insurance Corporation, National General Insurance Company, Nationwide Mutual Fire Insurance Company, Nationwide Life Insurance Company, Nationwide General Insurance Company, Nationwide Mutual Insurance Co., Nationwide Property & Casualty Insurance Company, National Casualty Company, Wausau Underwriters Insurance Co., Employers Insurance of Wausau a Mutual Company, American Economy Insurance Company, American States Life Insurance Company, American States Insurance Company, American States Preferred Insurance Company, Employers Health Insurance Company, American Continental Insurance Company, American Continental Life Insurance Company, Pharmacists Mutual Insurance Company, Plaintiffs-Appellants and Appellees,

v.

Stephen F. SELCKE, Director, the Department of Insurance, and Patrick Quinn, Treasurer of the State of Illinois, Defendants-Appellees and Appellants.

Nos. 1-00-1973, 1-00-1979.
July 17, 2001.
Rehearing Denied Aug. 27, 2001.

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JUSTICE COUSINS delivered the opinion of the court:

In this interlocutory appeal filed pursuant to Supreme Court Rule 308 (155 Ill.2d R. 308), the plaintiffs are a group of insurance companies incorporated outside Illinois that filed a complaint against defendants, the Director of the Illinois Department of Insurance and the Treasurer of the State of Illinois. Plaintiffs alleged that they were subject to an unconstitutional privilege tax that was not imposed on domestic insurance companies incorporated in Illinois. The plaintiffs further sought a refund of the privilege tax monies paid by them and deposited into a protest fund.

The trial court found that the privilege tax violated the uniformity clause of the Illinois Constitution (Ill. Const. 1970, art. IX, §2), as well as the equal protection clauses of the Illinois Constitution (Ill. Const. 1970, art. I, §2) and United States Constitution (U.S. Const., amend. XIV). Defendants appealed. The Illinois Supreme Court affirmed that the privilege tax violated the uniformity clause of the Illinois Constitution and found it unnecessary to consider plaintiffs' equal protection claims. *Milwaukee Safeguard Insurance Co. v. Selcke*, 179 Ill.2d 94, 104-05, 227 Ill.Dec. 731, 688 N.E.2d 68 (1997). The cause

was remanded for further proceedings. *Selcke*, 179 Ill.2d at 105, 227 Ill.Dec. 731, 688 N.E.2d 68.

On remand, as the trial court began to consider remedial issues, the defendants asserted the "pass-on" defense, which states: in order for the plaintiffs to be entitled to a tax refund, they must show that they bore the burden of the tax and did not pass it on to their policyholders, thereby receiving a windfall. The trial court held in favor of the defendants, ruling that the pass-on defense applied as a matter of law. The trial court then certified the following four questions for immediate interlocutory appeal: (1) whether the "pass-on defense" applies as a matter of law; (2) whether the plaintiffs have the burden of establishing that they bore the burden of the tax and did not receive a windfall; (3) whether defendants waived the issue of windfall; and (4) whether there should be further proceedings with respect to the amount of the windfall.

BACKGROUND

Plaintiffs are a group of insurance companies doing business in Illinois but incorporated in other states. Beginning in 1993, plaintiffs filed numerous suits challenging a privilege tax that was formerly imposed on foreign insurers. 215 ILCS 5/409 (West 1992).[1] As foreign companies, plaintiffs were required to pay a tax equal to 2% of their net premium income "for the privilege of doing business in this State." 215 ILCS 5/409(1) (West

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[1] This section of the Illinois Insurance Code was rewritten by Public Act 90-583 (Pub. Act 90-583, eff. May 29, 1998).

1992). In count I of their complaints, plaintiffs sought a declaration that the privilege tax was unconstitutional and an order for a refund of the protested payments. In count II, plaintiffs sought a declaration that if the privilege tax was found to be unconstitutional, they would not be required to pay an additional retaliatory tax under section 444 of the Insurance Code. 215 ILCS 5/444 (West 1992). Plaintiffs each paid the privilege tax under protest. 30 ILCS 230/2a.1 (West 1992). The trial court consolidated the suits.

In 1996, the trial court granted plaintiffs' motion for partial summary judgment on count I. The trial court held that the privilege tax unconstitutionally discriminated against foreign insurers in violation of the uniformity clause of the Illinois Constitution (Ill. Const. 1970, art. IX, §2) and the equal protection clauses of the Illinois Constitution (Ill. Const. 1970, art. I, §2) and the United States Constitution (U.S. Const., amend. XIV).

On October 23, 1997, the Illinois Supreme Court affirmed the trial court's decision, declaring that the privilege tax was unconstitutional under the uniformity clause because it exempted domestic insurance companies that met certain qualifications from payment of the tax but required foreign companies that met those same qualifications to pay the tax. *Selcke*, 179 Ill.2d at 101-03, 1227 Ill.Dec. 731, 688 N.E.2d 68. The court held that this requirement violated the uniformity clause because it was not reasonably related to any real and substantial difference between foreign and domestic insurance companies. *Selcke*, 179 Ill.2d at 101-03, 1227 Ill.Dec. 731, 688 N.E.2d 68. The cause was remanded for further proceedings.

After the Illinois Supreme Court's ruling, defendants paid refunds of the privilege tax to two plaintiffs. On remand, the trial court granted plaintiffs' motion for partial summary judgment on count II in June 1999, holding that retrospective application of the retaliatory tax would unconstitutionally discriminate against plaintiffs. Defendants filed a motion for reconsideration of the court's decision on count II. Although the motion was fully briefed and argued to the trial court in September 1999, the trial court has not yet ruled on that motion.

On February 8, 2000, defendants filed a motion to postpone ruling on their reconsideration motion, asking the court to delay its ruling because there might be arguments not made previously that bore on the constitutionality of the application of the retaliatory tax. Plaintiffs filed a motion to strike defendants' motion to postpone ruling. In response, on March 9, 2000, defendants raised the pass-on defense for the first time, arguing that plaintiffs should not be unjustly enriched by a tax refund or credit that they passed on to their policyholders. Defendants also indicated that the Governor had appointed a task force to draft an executive order to help resolve remedial issues raised in *Selcke*.

On May 23, 2000, defendants filed a discovery motion to proceed on the windfall issue. In the motion, defendants argued that the pass-on defense was applicable to these proceedings, that the plaintiffs had the burden to prove that they did not pass on the expense to their policyholders, and that the court should grant defendants discovery with respect to the pass-on defense. Plaintiffs opposed the discovery motion at a hearing two days later on May 25, arguing that the court should reject

the pass-on defense as a matter of law. Plaintiffs also argued that defendants had waived their right to assert the pass-on defense.

On June 1, 2000, the trial court ruled in favor of defendants concerning the availability of the pass-on defense. The court then issued an order certifying four questions relating to the availability of the pass-on defense, noted above, for immediate interlocutory appeal pursuant to Rule 308.

Plaintiffs filed a timely application for leave to appeal on June 15, 2000. Although defendants were the prevailing party on the certified issues and not required to petition for leave to appeal, defendants also filed an application for leave to appeal. The court subsequently granted the parties' joint motion to consolidate their applications.

We affirm and remand.

ANALYSIS

Plaintiffs rely on *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, Department of Business Regulation*, 496 U.S. 18, 110 S.Ct. 2238, 110 L.Ed.2d 17 (1990), to argue that the United States Supreme Court has rejected the pass-on defense as a matter of law. We disagree. To fully understand the implications of *McKesson*, it is necessary to examine the Court's decisions in two preceding cases that considered the pass-on defense: *United States v. Jefferson Electric Manufacturing Co.*, 291 U.S. 386, 54 S.Ct. 443, 78 L.Ed. 859 (1934), and *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984).

In *Jefferson,* the plaintiff manufacturer of auto parts applied for a sales tax refund, arguing that the articles sold were not auto parts within the meaning of the revenue statute. *Jefferson,* 291 U.S. at 389-90, 54 S.Ct. at 444, 78 L.Ed. at 866. The revenue statute further required the plaintiff to prove that it bore the burden of the tax and that the amount was not passed on to the ultimate purchaser. *Jefferson,* 291 U.S. at 391, 54 S.Ct. at 445, 78 L.Ed. at 861. The Court enforced this statutorily created pass-on defense, holding that the right to refund depended on an additional element that must be proven by the plaintiff. The Court explained that this restriction did not violate due process because:

> "This plainly is but another way of providing that the money shall go to the one who has been the actual sufferer and therefore is the real party in interest.
>
> * * * Statutes * * * requiring that suits be brought by the real rather than the nominal party in interest have been uniformly sustained when challenged as infringing the contract and due process clauses of the Constitution." *Jefferson,* 291 U.S. at 402, 54 S.Ct. at 449, 78 L.Ed. at 871-72.

In *Bacchus,* plaintiff liquor wholesalers sought a refund of an excise tax imposed on the sale of liquor at wholesale. Plaintiffs argued that the tax was unconstitutional because it contained an exemption for certain locally produced alcoholic beverages. *Bacchus,* 468 U.S. at 265, 104 S.Ct. at 3052, 82 L.Ed.2d at 205. The Court held that the tax violated the commerce clause (U.S. Const., art. I, §8, cl.3) by discriminating against interstate commerce and providing a direct commercial advantage to

local businesses. *Bacchus*, 468 U.S. at 273, 104 S.Ct. at 3056, 82 L.Ed.2d at 211.

After holding that the tax was unconstitutional, the Court further considered defendants' contention that the wholesalers were not entitled to refunds since they did not bear the economic incidence of the tax but passed it on as a separate addition to the price that their customers were legally obligated to pay. The Court characterized the pass-on defense as a refund issue which was essentially an issue of remedy. *Bacchus*, 468 U.S. at 277, 104 S.Ct. at 3058, 82 L.Ed.2d at 213. The Court noted that remedial issues were not considered by the state courts below and that the "federal constitutional issues involved may well be intertwined with, or their consideration obviated by, issues of state law." *Bacchus*, 468 U.S. at 277, 104 S.Ct. at 3058, 82 L.Ed.2d at 213. The Court then remanded the cause for further proceedings. *Bacchus*, 468 U.S. at 277, 104 S.Ct. at 3058, 82 L.Ed.2d at 213. In a subsequent case, the Court explained that *Bacchus* was remanded "solely for consideration of the pass-through defense." *James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529, 539, 111 S.Ct. 2439, 2445, 115 L.Ed.2d 481, 491 (1991).

Following *Bacchus*, the United States Supreme Court in *McKesson* affirmed that a Florida liquor excise tax that exempted locally produced alcoholic beverages was unconstitutional for violating the commerce clause. The Court noted that the Florida Supreme Court below had denied plaintiffs a refund, however, due to "equitable considerations" which included the pass-on defense. *McKesson*, 496 U.S. at 44, 110 S.Ct. at 2254, 110 L.Ed.2d at 41. The Supreme Court rejected the Florida court's use of the pass-on defense for two reasons.

First, the Court found the following statement by the Florida Supreme Court to be sheer speculation:

> "[I]f given a refund, [plaintiffs] in all probability receive a windfall, since the cost of the tax has likely been passed on to [its] customer." *Division of Alcoholic Beverages & Tobacco, Department of Business Regulation v. McKesson Corp.*, 524 So.2d 1000, 1010 (Fla. 1988).

Neither party had the opportunity to present evidence concerning the extent, if any, of the plaintiff's ability to pass on the economic burden of the excise tax to its consumers or suppliers. *McKesson*, 496 U.S. at 46 n.30, 110 S.Ct. at 2255 n.30, 110 L.Ed.2d at 42 n.30. The Court admonished:

> "[D]etermining whether a particular business cost has in fact been passed on to customers or suppliers entails a highly sophisticated theoretical and factual inquiry; a court certainly cannot withhold part of a refund otherwise required to rectify an unconstitutional deprivation without first satisfactorily engaging in this inquiry." *McKesson*, 496 U.S. at 47, 110 S.Ct. at 2255, 110 L.Ed.2d at 42.

Second, the Court emphasized that, unlike *Jefferson*, which involved a mere tax overassessment, the plaintiff in *McKesson* was subject to a discriminatory tax and therefore suffered a twofold injury – not only was he poorer in the absolute sense, but the tax also placed him at a competitive disadvantage in the marketplace in violation of the commerce clause. *McKesson*, 496 U.S. at 47-49, 110 S.Ct. at 2256-57, 110 L.Ed.2d at 42-43. The Court reasoned that, in the face of a discriminatory tax, the

Florida Supreme Court's mere passing reference to "equitable considerations" did not justify the state's attempt to avoid bestowing a so-called "windfall." *McKesson*, 496 U.S. at 47, 110 S.Ct. at 2256, 110 L.Ed.2d at 42. The Court noted that neither the Florida Supreme Court nor the state had cited any authority to support the view that Florida law recognized a nonstatutory pass-on defense in the context of a discriminatory tax. *McKesson*, 496 U.S. at 47-49, 110 S.Ct. at 2256-57, n.34, 110 L.Ed.2d at 42-43.

The plaintiffs rely on *McKesson* to argue that the pass-on defense cannot apply as a matter of law in a discriminatory tax case. We are not persuaded by the plaintiffs' overly broad reading of *McKesson*, especially in light of the United States Supreme Court's decision in *James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529, 111 S.Ct. 2439, 115 L.Ed.2d 481 (1991), decided one year after *McKesson*. Like *Bacchus* and *McKesson*, *Beam* involved a liquor tax that discriminated against interstate commerce by exempting alcoholic beverages that were locally produced. Although *Beam* did not specifically address the question of the pass-on defense, the Court did comment that *Bacchus* was remanded solely to consider the pass-on defense without indicating any disapproval of such a result. *Beam*, 501 U.S. at 539, 111 S.Ct. at 2445, 115 L.Ed.2d at 491. In fact, the Court's reading of *Bacchus* further emphasizes that the use of the pass-on defense was not presumptively invalid in a discriminatory tax case after *McKesson*:

> "Although the taxpaying appellants prevailed on the merits of their Commerce Clause claim, however, the *Bacchus* Court did not grant outright their request for a refund of taxes paid

> under the law found unconstitutional. Instead, we remanded the case for consideration of the State's arguments that appellants were 'not entitled to refunds since they did not bear the economic incidence of the tax but passed it on as a separate addition to the price that their customers were legally obligated to pay.' " *Beam*, 501 U.S. at 538-39, 111 S.Ct. at 2445, 115 L.Ed.2d at 490, quoting *Bacchus*, 468 U.S. at 276-77, 104 S.Ct. at 3058, 82 L.Ed.2d at 213.

The Court then remanded the case to consider an appropriate remedy because "remedial issues were neither considered below nor argued to this Court, save for an effort by petitioner to buttress its claim by reference to our decision last Term in *McKesson*." *Beam*, 501 U.S. at 544, 111 S.Ct. at 2448, 115 L.Ed.2d at 494. The Court went on to state:

> "Nothing we say here deprives respondents of their opportunity to raise *procedural bars to recovery under state law* or demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided, a matter with which *McKesson* did not deal." (Emphasis added.) *Beam*, 501 U.S. at 544, 111 S.Ct. at 2448, 115 L.Ed.2d at 494.

In fact, on remand the Georgia Supreme Court held that, under the pass-on defense, the plaintiffs were procedurally barred from pursuing an action for refund because the "[United States] Supreme Court invited the State to invoke, on remand, independent procedural bases for its refusal to provide a refund." *James B. Beam Distilling Co. v. State*, 263 Ga. 609, 610, 437 S.E.2d 782, 784 (1993).

In our view, the United States Supreme Court did not preclude the use of the pass-on defense in a discriminatory tax case. In *Bacchus* and *Beam* the state courts had not considered remedial issues and the United States Supreme Court therefore allowed consideration of the pass-on defense on remand. By contrast, in *McKesson* the Florida Supreme Court had considered remedial issues but the United States Supreme Court was not persuaded that mere reference to "equitable considerations" without further support from Florida law would justify the use of the pass-on defense in a discriminatory tax case.

McKesson is distinguishable from the instant case. Unlike the defendant in *McKesson*, defendants here have cited an Illinois Supreme Court case that supports the use of a nonstatutory pass-on defense in a discriminatory tax case. See *Consolidated Distilled Products, Inc. v. Mahin*, 56 Ill.2d 110, 306 N.E.2d 465 (1973). In *Consolidated*, plaintiff wine distributors sued for a refund of taxes that were imposed on wine made from grapes grown outside Illinois. Wine made from grapes grown in Illinois was taxed at a lower rate than wine made from grapes grown outside Illinois. Plaintiffs alleged that the differential tax rate violated numerous clauses of the United States and Illinois Constitutions, including the commerce clause. *Consolidated*, 56 Ill.2d at 116, 306 N.E.2d 465. Certain individuals who had allegedly purchased wine at retail were also permitted to intervene on behalf of all wine purchasers in Illinois. It was their position that any reimbursement should accrue to the ultimate purchasers who had actually borne the burden of the tax. *Consolidated*, 56 Ill.2d at 116, 306 N.E.2d 465. Thus, on the one hand a tax refund was claimed by the plaintiffs because they paid

the tax, and on the other hand by the intervenors, who asserted that they bore the actual burden of the tax.

The Illinois Supreme Court found that a threshold issue was whether the plaintiffs, in order to establish their right to a refund, must show that they bore the burden of the tax. If neither party was entitled to a refund, the court reasoned that it would be unnecessary to review the constitutional validity of the tax. *Consolidated,* 56 Ill.2d at 116, 306 N.E.2d 465. The court found that Illinois law recognized a general policy against unjust enrichment through the refund of illegal taxes and cited its decision in *Benzoline Motor Fuel Co. v. Bollinger,* 353 Ill. 600, 187 N.E. 657 (1933) (recognizing the legitimacy of a pass-on defense in the absence of any statute). The court also examined the statutory policy against unjust enrichment found in tax refund statutes like the Retailers' Occupation Tax Act (Ill.Rev.Stat.1971, ch. 120, par. 440 *et seq.*) and the United States Supreme Court's decision in *Jefferson,* 291 U.S. 386, 54 S.Ct. 443, 78 L.Ed. 859 (the proper party to recover a tax illegally exacted is the person actually bearing the burden of the tax). According to the court, simply because the Illinois General Assembly did not specifically incorporate provisions against unjust enrichment in the statute at issue did not repudiate the state's general policy against unjust enrichment. *Consolidated,* 56 Ill.2d at 118-19, 306 N.E.2d 465.

Thus, the court held not only that the plaintiffs must show as a matter of law that they bore the burden of the tax, but that they failed as a matter of fact to do so. The court stated:

> "There has been no showing that [the plaintiffs] bore the burden of the tax. The only proof that bears upon that question is the stipulation * * * that shows, or tends to show, that they passed the tax on to the retailers to whom they sold." *Consolidated*, 56 Ill.2d at 119, 306 N.E.2d at 465.

Absent such a showing, the court concluded that the plaintiffs did not have a right to a refund. See also *Estate of Carey v. Village of Stickney*, 81 Ill.2d 406, 413, 44 Ill.Dec. 240, 411 N.E.2d 209 (1980) (discussing "the State's policy against unjust enrichment" which forbade racetrack licensee from keeping money collected from ticket holders under illegal tax); *Schlessinger v. Olsen*, 102 Ill.2d 497, 502, 82 Ill.Dec. 378, 468 N.E.2d 1158 (1984) (mentioning the "general proposition" that only those who have borne the burden of an unconstitutional tax may seek a refund); *Silver Fox Limousine v. City of Chicago*, 306 Ill.App.3d 103, 114, 239 Ill.Dec. 52, 713 N.E.2d 583 (1999) (approving rationale behind statutorily created pass-on defense which "simply prevent[ed] ground transportation providers from receiving a windfall by recovering the amount of the tax twice and ensure[d] that the actual taxpayer receive[d] the benefit of a refund or credit").

Plaintiffs cite a number of tax refund cases to claim that Illinois law does not recognize the pass-on defense. See *Kerasotes Rialto Theater Corp. v. City of Peoria*, 77 Ill.2d 491, 34 Ill.Dec. 118, 397 N.E.2d 790 (1979); *Searle Pharmaceuticals, Inc. v. Department of Revenue*, 117 Ill.2d 454, 111 Ill.Dec. 603, 512 N.E.2d 1240 (1987); *Venture Stores, Inc. v. Ryan*, 286 Ill.App.3d 673, 222 Ill.Dec. 688, 678

N.E.2d 300 (1997); *Geja's Cafe v. Metropolitan Pier & Exposition Authority*, 153 Ill.2d 239, 180 Ill.Dec. 135, 606 N.E.2d 1212 (1992); *Shell Oil Co. v. Department of Revenue*, 95 Ill.2d 541, 70 Ill.Dec. 191, 449 N.E.2d 65 (1983); *Kraft, Inc. v. Sweet*, 213 Ill.App.3d 889, 157 Ill.Dec. 320, 572 N.E.2d 389 (1991); *Western Union Telegraph Co. v. Lewis*, 7 Ill.App.3d 285, 287 N.E.2d 169 (1972). However, in those cases, the pass-on defense was never raised by any party. The cases cited simply demonstrate that where the pass-on defense is not codified by the applicable tax refund statute and therefore not a required element of the plaintiff's refund action, Illinois law does not require plaintiffs to prove that they bore the burden of the tax before being entitled to a refund. Rather, in such cases, the parties have discretion to choose whether to raise the pass-on defense.

Plaintiffs also assert that the pass-on defense is a question of standing and that the defendants have waived the issue by failing to raise it in their answer as an affirmative defense. Although some Illinois cases have characterized the defense as a threshold standing inquiry (*Consolidated*, 56 Ill.2d at 116, 306 N.E.2d 465; *Consolidated Distilled Products, Inc. v. Allphin*, 73 Ill.2d 19, 29, 21 Ill.Dec. 853, 382 N.E.2d 217 (1978)), the United States Supreme Court has repeatedly asserted that the pass-on defense is a "refund" issue that may be considered at the remedy phase of an action. See *Bacchus*, 468 U.S. at 277, 104 S.Ct. at 3058, 82 L.Ed.2d at 213 (remanded the case solely for consideration of pass-on defense, a "refund issue [ ], * * * essentially [an] issue [ ] of remedy"); *McKesson*, 496 U.S. at 46-49, 110 S.Ct. at 2255-57, 110 L.Ed.2d at 42-43 (pass-on defense considered a remedial question); *Beam*, 501 U.S. at 538-39, 111 S.Ct. at 2445, 115 L.Ed.2d at 490

(characterizing the pass-on defense as a remedial issue). In light of the Supreme Court's precedents, we hold that it was not improper for defendants to raise the pass-on defense for the first time at the remedial phase of the litigation.

Finally, we turn to the question of allocation of the burden of proof. The party challenging a taxpayer's entitlement to a refund, in this case the defendants, undoubtedly bears the burden of raising the pass-on defense. Once such a defense is raised, however, it becomes the taxpayer's burden to show that it did not pass on the tax to another party. *Consolidated,* 56 Ill.2d at 119, 306 N.E.2d 465. Since Illinois law does not foreclose the defendants' use of the pass-on defense as a matter of law in the instant case, the cause shall be remanded for further proceedings not inconsistent with this opinion.

In conclusion, we respond to the four questions certified in this Rule 308 appeal as follows:

> (1) The "pass-on defense" applies as a matter of law in the instant case;
>
> (2) since the pass-on defense has been raised by the defendants, the plaintiffs now have the burden of establishing that there was no windfall;
>
> (3) defendants did not waive the issue of windfall because the pass-on defense may be considered at the remedial phase of litigation; and
>
> (4) further proceedings are appropriate with respect to determining the amount of windfall.

For the foregoing reasons, the trial court's ruling is affirmed and the cause is remanded.

Affirmed and remanded.

CAHILL, P.J., and GORDON, J., concur.

No. 1-00-1973 and 1-00-1979
(Consolidated)

IN THE
APPELLATE COURT OF ILLINOIS
FIRST JUDICIAL DISTRICT

MILWAUKEE SAFEGUARD INSURANCE COMPANY, et. al., Plaintiffs-Appellants, v. STEVEN F. SELCKE, Director of the Illinois Department of Insurance, and PATRICK QUINN, Treasurer of the State of Illinois, et al., Defendants-Appellees.	Appeal from the Circuit Court of Cook County No. 93 L 50663, etc. (Consolidated) The Honorable Alexander P. White, Judge Presiding.

ORDER

This matter having come on to be heard on the petition for rehearing of plaintiffs-appellants, and the court being advised of the premises,

IT IS HEREBY ORDERED that the petition is denied.

/s/ William Cousins
JUSTICE

ORDER ENTERED
AUG 27 2001
APPELLATE COURT,
FIRST DISTRICT

/s/ Joseph Gordon
JUSTICE

/s/ Robert Cahill
JUSTICE

STEVE M. RAVID,
CLERK OF THE APPELLATE COURT,
FIRST DISTRICT

Nos. 1-00-1973 and 1-00-1979
(Consolidated)

IN THE APPELLATE COURT OF ILLINOIS
FIRST DISTRICT - SECOND DIVISION

MILWAUKEE SAFEGUARD INSURANCE COMPANY, et al.,

Plaintiffs-Appellants,

v.

STEPHEN F. SELCKE, Director of the Illinois Department of Insurance, and PATRICK QUINN, Treasurer of the State of Illinois, et al.,

Defendants-Appellees.

On Rule 308 Appeal from the
Circuit Court of Cook County, Illinois, County Department, Law Division, Tax and Miscellaneous Remedies Section
No. 93 L 50663, etc. (Consolidated)
The Honorable Alexander P. White, Judge Presiding

ORDER

This matter coming on to be heard on Plaintiffs' Application for Certification, the Court having reviewed the Application for Certification and being otherwise fully advised in the premises, hereby ~~GRANTS~~/DENIES the Application for Certification.

Dated: August ___, 2001

ORDER ENTERED
AUG 16 2001
APPELLATE COURT,
FIRST DISTRICT

/s/ William Cousins
Hon. _____

/s/ Joseph Gordon
Hon. _____

_____
Hon. _____

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT, LAW DIVISION
TAX AND MISCELLANEOUS REMEDIES SECTION

MILWAUKEE SAFEGUARD INSURANCE COMPANY, et al.	) Case Nos. 93 L 50663-50665, 50668, 50674, 50698, 50699, 50971-50977, 50988, 50997-51001, 51038-5042, 51057, 51066, 51371, 51373, 51374, and 51377, 93 CH 9266-9269, 94 L 50419, 50629, and 50915, 94 L 50874, and 50875, 96 L 51106, 51107, 51124, 55125, and 51141, 97 L 50032-50037, and 50468, 98 L 50012 (consolidated)
Plaintiffs.	
vs.	
STEPHEN F. SELCKE, Director of the Illinois Department of Insurance, and PATRICK QUINN, Treasurer of the State of Illinois,	
Defendants.	) Hon. Alexander P. White

CORRECTED ORDER

THIS CAUSE COMING to be heard for the entry of an Order on Defendants' Motion to Proceed on Windfall Issue and Plaintiffs' Emergency Motion to Bring Additional Matters to the Court's Attention Regarding the Issuance of a Rule 308 Order for Interlocutory Appeal and to Resolve Remaining Legal Issues, due notice having been given, the Court having heard argument in open Court and being fully advised in the premises:

IT IS HEREBY ORDERED THAT:

1. The issue of windfall applies as a matter of law,
2. Pursuant to Supreme Court Rule 308(a) this Court finds that this Order that the issue of windfall applies involves questions of law as to which

there are substantial grounds for difference of opinion and further finds that an immediate appeal of this Order may materially advance the ultimate termination of this litigation,

3. This Court herewith identifies the following questions, the resolution of which by immediate appeal may materially advance the termination of this litigation:

   A. Whether the plaintiffs had the burden of establishing there was no windfall; an issue plaintiffs identify as the "pass-on defense;"

   B. Whether the windfall issue was waived by the defendants;

   C. Whether there should be further proceedings in respect to the amount of the windfall;

   D. Whether windfall applies as a matter of law.

JUDGE ALEXANDER P. WHITE
JUN 05 2000
CIRCUIT COURT - 241

Dated: _____

Alexander P. White,
Circuit Judge

Prepared by:

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Illinois Supreme Court

(No. 82047. – Affirmed and remanded.)

MILWAUKEE SAFEGUARD INSURANCE COMPAY *et al.*, Appellees, v. STEPHEN F. SELCKE, Director of Insurance, *et al.*, Appellants.

Opinion filed October 23, 1997. – Rehearing denied December 1, 1997.

BILANDIC, J., joined by FREEMAN, C.J., and McMORROW, J., dissenting.

Appeal from the Circuit Court of Cook County, the Hon. Randye A. Kogan, Judge, presiding.

James E. Ryan, Attorney General, of Springfield (Barbara A. Preiner, Solicitor General, of Chicago, and Robert E. Wagner, Special Assistant Attorney General, of Springfield, of counsel), for appellants.

Richard Bromley, R. Lee Christie, Mary Kay McCalla Martire, Bruce W. Doughty, Tracy D. Williams and John T. Hildy, of Hopkins & Sutter, of Chicago, for appellees Milwaukee Guardian Insurance Co. *et al.*

Michael J. Hayes and John A. Simon, of Gardner, Carton & Douglas, of Chicago, for appellees American Economy Insurance Co. *et al.*

Sharon Doherty and Steven B. Belgrade, of Belgrade & O'Donnell, P.C., of Chicago, for appellees American Continental Insurance Co. *et al.*

David A. Hughes, of Horwood, Marcus & Braun, of Chicago, for appellees Motors Insurance Corp. *et al.*

Cornelius E. McKnight, of Condon & Cook, of Chicago, for appellee Pharmacists Mutual Cos.

Michael T. Trucco and Jane W. Grover, of Stamos & Trucco, of Chicago, for appellee Royal Macabees Life Insurance Co.

William T. Barker and Mark L. Hanover, of Sonnenchein, Nath & Rosenthal, of Chicago, for *amici curiae* Allstate Insurance Co. *et al.*

Beth Anne Janicki, of Springfield, for *amicus curiae* Illinois Municipal League.

JUSTICE HEIPLE delivered the opinion of the court:

Defendants, the Director of Insurance and the Treasurer of the State of Illinois, contend that the circuit court erred in declaring unconstitutional section 409 of the Illinois Insurance Code (215 ILCS 5/409 (West 1992)), which imposes an annual privilege tax on foreign or alien insurance companies. For the reasons that follow, we affirm the circuit court's judgment.

FACTUAL AND PROCEDURAL HISTORY

Plaintiffs are insurance companies doing business in Illinois but incorporated in other states. As foreign companies, plaintiffs are required by section 409 of the Illinois Insurance Code (the Code) to pay a tax equal to 2% of their net premium income "for the privilege of doing business in this State." 215 ILCS 5/409(1) (West 1992). Plaintiffs each paid the privilege tax under protest. See 30 ILCS 230/2a.1 (West 1992). They then brought numerous suits alleging that the privilege tax is facially unconstitutional under the uniformity clause of the Illinois Constitution of 1970 (Ill. Const. 1970, art. IX, § 2) and the equal protection clauses of the Illinois Constitution (Ill. Const.

1970, art. I, § 2) and the United States Constitution (U.S. Const., amend. XIV). Plaintiffs sought a refund of payments they had made under the privilege tax.[1] The circuit court consolidated the suits.

Plaintiffs then successfully moved for partial summary judgment. In a memorandum decision, the circuit court declared that section 409 of the Code violates the uniformity clause of the Illinois Constitution (Ill. Const. 1970, art. IX, § 2) because it exempts domestic insurance companies who meet certain qualifications from payment of the privilege tax, but requires foreign companies who meet those same qualifications to pay the tax. The court held that this requirement violates the uniformity clause because it is not rationally related to any real and substantial difference between foreign and domestic insurance companies. The court also ruled that section 409 violates the equal protection clauses of the Illinois Constitution (Ill. Const. 1970, art. I, § 2) and the United States Constitution (U.S. Const., amend. XIV).

ANALYSIS

A trial court may render summary judgment if the record shows that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. 735 ILCS 5/2-1005(c) (West

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[1] Plaintiffs also sought a declaration that if the privilege tax were declared unconstitutional, they would not be required to pay any additional retaliatory tax under section 444 of the Insurance Code (215 ILCS 5/444 (West 1992)). This issue was not included, however, in plaintiffs' motion for partial summary judgment, and the circuit court thus did not address it.

1992). In an appeal from a grant of summary judgment, we conduct a *de novo* review. *Crum & Forster Managers Corp. v. Resolution Trust Corp.*, 156 Ill. 2d 384, 390 (1993).

Article IX, section 2, of the Illinois Constitution provides as follows:

> "In any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subjects and objects within each class shall be taxed uniformly. Exemptions, deductions, credits, refunds and other allowances shall be reasonable." Ill. Const. 1970, art. IX, § 2.

To survive scrutiny under the uniformity clause, a non-property tax classification must (1) be based on a real and substantial difference between the people taxed and those not taxed, and (2) bear some reasonable relationship to the object of the legislation or to public policy. *Allegro Services, Ltd. v. Metropolitan Pier & Exposition Authority*, 172 Ill. 2d 243, 250 (1996); *Searle Pharmaceuticals, Inc. v. Department of Revenue*, 117 Ill. 2d 454, 468 (1987).

The party attacking a tax classification is not required to negate every conceivable basis which might support it. *Searle*, 117 Ill. 2d at 468. Rather, upon a good-faith uniformity challenge, the taxing body bears the initial burden of producing a justification for the classifications. The party challenging the classification then has the burden of persuading the court that the justification offered is unsupported by the facts or insufficient as a matter of law. *Allegro Services*, 172 Ill. 2d at 255; *Geja's Cafe v. Metropolitan Pier & Exposition Authority*, 153 Ill. 2d 239, 248-49 (1992).

Section 409 of the Code provides in pertinent part:

"(1) Every foreign or alien company doing an insurance business in this State, except fraternal benefit societies, shall, for the privilege of doing business in this State * * * pay to the Director for the State treasury a State tax equal to 2 per cent of the net taxable premium income * * * . Every domestic insurance company, except a fraternal benefit society, which fails to comply with all the requirements of subsection (4) of this Section must pay to the Director for payment into the State Treasury a State tax equal to 2 per cent of the net taxable premium income * * * .

* * *

(4) A domestic company must pay the State tax in subsection (1) of this Section unless:

(a) it maintains its principal place of business in this State; and

(b) it maintains in this State officers and personnel knowledgeable of and responsible for the company's operation, books, records, administration, and annual statement; and

(c) it conducts in this State substantially all of its underwriting, policy issuing, and serving operations relating to Illinois policyholders and certificate holders; and

(d) it complies with the provisions of Section 133(2) of this Code."[2] 215 ILCS 5/409 (West 1992).

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[2] Section 133(2) requires that corporate books, records, documents, accounts and vouchers be preserved and kept available in Illinois. 215 ILCS 5/133(2) (West 1992).

Section 2 of the Code defines a "domestic company" as a company incorporated or organized under the laws of Illinois, and a "foreign company" as a company incorporated or organized under the laws of any state of the United States other than Illinois. 215 ILCS 5/2(f), (g) (West 1992).

The circuit court held that section 409 violates the uniformity clause because it allows domestic companies to avoid payment of the privilege tax if they meet the requirements contained in paragraph (4), but does not allow foreign companies to avoid payment of the tax even if they meet those same requirements.

Defendants offer the following justification for allowing domestic but not foreign companies to avoid payment of the privilege tax. Defendants assert that regulation of foreign insurance companies presents greater regulatory and administrative burdens than regulation of domestic companies. Specifically, defendants note that the Illinois Department of Insurance has certain regulatory powers over domestic companies which it does not have over foreign companies. For example, the Department is authorized to conduct the liquidation of insolvent domestic, but not foreign, companies. See 215 ILCS 5/188 (West 1992). The Department also has power to issue corrective orders to financially troubled domestic companies with regard to such activities as underwriting, marketing, and use of company assets, but it does not have such power over foreign companies. See 215 ILCS 5/186.1 (West 1992). Furthermore, the department's revocation of a domestic company's certificate of authority requires that company to cease operating, while such a revocation against a foreign company merely prohibits the company

from doing business in Illinois. See 215 ILCS 5/119 (West 1992). Defendants contend that these regulatory powers which the Department exercises over domestic companies are crucial to guaranteeing the solvency of insurers doing business in Illinois. Defendants assert that the Department's lack of such powers over foreign companies constitutes a real and substantial difference between foreign and domestic companies.

We agree with defendants' contention that the disparity in the Department's powers over foreign and domestic insurance companies constitutes a real and substantial difference between those who pay the privilege tax and those who do not. Foreign insurance companies stand in a different relationship to the Illinois regulatory regime than do domestic companies. Even if a foreign company were to comply with the requirements of section 409(4), it would not be identically situated to a complying domestic company because the department would nevertheless lack the aforementioned regulatory powers over the foreign company.

Having determined that the classification of foreign and domestic insurance companies found in section 409 is based on a real and substantial difference between those companies who pay the privilege tax and those who do not, we must next consider whether that classification bears a reasonable relationship to the object of the legislation or to public policy. *Searle Pharmaceuticals,* 117 Ill. 2d at 468.

Although defendants assert that foreign insurance companies pose greater regulatory burdens than domestic companies, we note that, in addition to the privilege

tax, foreign companies are required to pay all expenses incurred by the Illinois Department of Insurance in examining those companies, including lodging and travel expenses. See 215 ILCS 5/132.4(d), 408(3) (West 1992). The privilege tax is therefore obviously not intended to compensate the state for any additional expenses associated with regulating foreign insurance companies, since those companies are already required to pay such expenses.

Defendants contend, however, that taxing foreign insurance companies for the privilege of doing business in Illinois encourages those companies to incorporate in Illinois, either directly or through a subsidiary. This in turn advances the interests of Illinois policyholders, defendants argue, because the Department of Insurance possesses greater regulatory authority over Illinois companies. Defendants thus assert that imposing the privilege tax on foreign companies as an inducement to incorporate in Illinois bears a reasonable relationship to the legislative objective of enhancing the security of Illinois policyholders.

Before evaluating the merits of this argument, we first note the unique nature of the constitutional provision at issue in this case. Article IX, section 2, of the Illinois Constitution of 1970 was intended to serve as a specific limitation on the taxing power of the Illinois General Assembly. *Searle*, 117 Ill. 2d at 466-67. The provision "was not made to duplicate the limitation on the taxing power contained in the equal protection clause." *Searle*, 117 Ill. 2d at 467. Rather, the uniformity clause was meant to insure that "taxpayers * * * receive added protection in the state constitution" based on "standards of

reasonableness which are more rigorous than those developed under the federal constitution." 7 Record of Proceedings, Sixth Illinois Constitutional Convention 2062, 2074 (Report of the Committee on Revenue and Finance, *Section 1 – State Revenue Power*).

Applying these more rigorous standards of reasonableness, we conclude that imposing the privilege tax on all foreign insurance companies does not bear a reasonable relationship to the object of the legislation or to public policy. As noted above, the privilege tax is not necessary to compensate the state for the additional costs of regulating foreign companies, since those companies are already required to pay such additional costs. Furthermore, while the Department of Insurance lacks certain regulatory powers over foreign companies which it enjoys over domestic companies, simply collecting a privilege tax from foreign companies does not bestow such powers on the Department. Foreign companies pose the same regulatory obstacles to the Department with or without the tax.

Although defendants assert that the privilege tax promotes the interests of Illinois policyholders by inducing foreign companies to incorporate in Illinois, we believe that such an approach to achieving regulatory control imposes an unreasonable burden upon foreign insurance companies under the uniformity clause. Foreign companies which meet all of the recordkeeping and business requirements of section 409(4), and which pay all expenses of their regulation by the Department of Insurance, must nevertheless pay the privilege tax. Assessing the tax does not bear a reasonable relationship to protecting the interests of Illinois policyholders

because the tax is imposed on all foreign companies regardless of their financial strength or their level of compliance with the requirements of section 409(4). Furthermore, if the domestic regulatory powers lauded by defendants are as effective as asserted, an irresponsible foreign company has a strong incentive to escape such Illinois regulation indefinitely by merely continuing to pay the privilege tax and remaining incorporated outside of Illinois. In light of the rigorous standards mandated by the uniformity clause, we believe that imposing the privilege tax on foreign companies solely because they are not incorporated in Illinois is not a permissible use of the General Assembly's taxing power.

Defendants also contend that there are genuine issues of material fact in this case which preclude the entry of summary judgment. Specifically, defendants dispute the allegation contained in plaintiffs' motion for summary judgment that all foreign insurance companies are required to pay the privilege tax. Defendants point out that many foreign companies have formed Illinois subsidiaries which qualify for the tax exemption afforded to domestic companies.

We do not believe that this issue constitutes a factual dispute precluding summary judgment. As the circuit court noted, Illinois subsidiaries are entitled to exemption from the tax because they are legally independent entities incorporated under the laws of Illinois. Companies incorporated under the laws of states other than Illinois, such as plaintiffs, must still pay the tax if they themselves wish to conduct business in Illinois. Thus, no genuine fact issue exists on this point.

Defendants also contend that the circuit court erred in failing to consider their own motion for summary judgment. The court's granting of plaintiffs' summary judgment motion, however, obviated the need to rule on defendants' motion. Furthermore, as defendants themselves acknowledge, the circuit court considered defendants' arguments in the course of ruling on plaintiffs' motion.

Finally, defendants contend that plaintiffs lack standing to challenge the privilege tax because plaintiffs have not demonstrated that they meet the qualifications outlined in section 409(4) allowing domestic companies to avoid payment of the tax. This contention mistakenly assumes that plaintiffs' objection to the privilege tax depends on the exemption granted to domestic companies in section 409(4). Plaintiffs' argument, however, is simply that the privilege tax is facially unconstitutional because it is imposed on all foreign insurance companies based solely on their state of incorporation. This facial challenge applies regardless of the operation of section 409(4). The fact that certain domestic companies are allowed to avoid payment of the tax under section 409(4) merely serves to illustrate the absence of a reasonable relationship between the taxing classification and the object of the legislation. See *Searle*, 117 Ill. 2d at 468.

For the reasons stated, we hold that section 409 of the Illinois Insurance Code (215 ILCS 5/409 (West 1992)) violates article IX, section 2, of the Illinois Constitution of 1970. Because of this holding, it is unnecessary for us to address the circuit court's ruling that section 409 also violates the equal protection clauses of the Illinois and United States Constitutions.

The cause is remanded to the circuit court for further proceedings consistent with this opinion.

Affirmed and remanded.

Justice BILANDIC, dissenting:

I disagree with the majority's conclusion that section 409 of the Illinois Insurance Code (215 ILCS 5/409 (West 1992)) facially violates the uniformity clause of the Illinois Constitution of 1970 (Ill. Const. 1970, art. IX, § 2). I therefore dissent.

Section 409 imposes a 2% tax on net taxable premium income collected on insurance policies written in Illinois. Domestic insurance companies, however, are not required to pay the premium tax if they meet certain exemption requirements, such as maintaining in Illinois their principal place of business; maintaining in Illinois officers and personnel knowledgeable of and responsible for the company's operation, books, records, and administration; conducting in Illinois substantially all underwriting, policy issuing, and serving operations relating to Illinois policyholders; and keeping in Illinois suitable copies of the corporate books, records, documents, accounts, and vouchers. 215 ILCS 5/409, 133(2) (West 1992). Accordingly, under this statutory scheme, all foreign insurance companies are liable for the premium tax, whereas domestic insurance companies are also liable for the tax, unless they meet the extensive exemption requirements.

Plaintiffs, a group of foreign insurance companies, challenge this statutory scheme as unconstitutional on its face under both the uniformity clause of the Illinois Constitution and the equal protection clauses of the Illinois

and United States Constitutions. I would hold that section 409 withstands their constitutional challenges.

I. Uniformity Clause

As the majority correctly notes, to survive scrutiny under the uniformity clause, a nonproperty tax classification must (1) be based on a real and substantial difference between the people taxed and those not taxed, and (2) bear some reasonable relationship to the object of the legislation or to public policy. The circuit court concluded that section 409 on its face violates the uniformity clause because it fails to satisfy the first prong of this test. The circuit court determined that there is no real and substantial difference between foreign and domestic insurance companies that fulfill the exemption criteria. The majority disagrees with this finding and concludes that the first prong of this test is satisfied. After giving a few concrete examples of Illinois' regulatory power disparity over foreign and domestic insurance companies, the majority rightly concludes that the premium tax classification, which distinguishes between foreign and domestic insurance companies, is based on this real and substantial difference between them. As the majority opinion explains: "Foreign insurance companies stand in a different relationship to the Illinois regulatory regime than do domestic companies. Even if a foreign company were to comply with the requirements of section 409(4), it would not be identically situated to a complying domestic company because the Department would nevertheless lack the aforementioned regulatory powers over the foreign company." 179 Ill. 2d at 101. I agree with the majority's conclusion as to the first prong of the test.

Where I depart from the majority is with its conclusion regarding the second prong. Under it, the premium tax classification must be upheld if it bears some reasonable relationship to the object of the legislation or to public policy. A proper application of this court's precedents demonstrates that this prong is also satisfied.

The scope of a court's inquiry under the uniformity clause remains relatively narrow. *Allegro Services, Ltd. v. Metropolitan Pier & Exposition Authority,* 172 Ill. 2d 243, 250 (1996). As this court has explained:

> "Statutes bear a presumption of constitutionality, and broad latitude is afforded to legislative classifications for taxing purposes. [Citation.] *One challenging a nonproperty tax classification has the burden of showing that it is arbitrary or unreasonable, and if a state of facts can reasonably be conceived that would sustain the classification, it must be upheld.*" (Emphasis added.) *Allegro Services, Ltd.,* 172 Ill. 2d at 250-51.

The following procedural process is used to determine whether a statute violates the uniformity clause. Upon a good-faith uniformity challenge, a taxing body bears the initial burden of producing a justification for its nonproperty tax classification. Once done, the plaintiff bears the burden of persuading the court that the justification is not supported by facts or is insufficient as a matter of law. The plaintiff who fails to meet its burden of persuasion loses, and the tax classification will be upheld. *Geja's Cafe v. Metropolitan Pier & Exposition Authority,* 153 Ill. 2d 239, 248-49 (1992).

In the present case, defendants have met their burden of producing a justification for the premium tax classification. They assert that the classification was drawn by the General Assembly in an effort to increase the efficiency and effectiveness of Illinois' regulation of the insurance industry, which is necessary to protect Illinois policyholders from insurer insolvency. Section 409 aids this purpose by offering tax incentives to companies for such things as locating their books, records, and personnel in Illinois, which in turn makes those companies easier to regulate. The tax incentives are also offered to encourage companies to make Illinois their corporate domicile, which then subjects those companies to greater Illinois regulatory control. When the exemption requirements are complied with, Illinois policyholders win greater protection from insurer insolvency because Illinois regulatory authorities are then enabled to identify insurer insolvency problems well in advance of a crisis, and are also empowered to take the actions necessary to protect policyholders. In addition, defendants described in detail the difficulties that Illinois regulators have had in the past monitoring foreign insurance companies. Offering tax incentives was thought by the General Assembly to be a constructive way in which to address this serious problem.

The foregoing regulatory justification having been produced, plaintiffs bear the heavy burden of persuading the court that this asserted justification is not supported by facts or is insufficient as a matter of law. *Geja's Cafe*, 153 Ill. 2d at 248-49. Plaintiffs here do not even attempt to show that defendants' regulatory justification is not supported by the facts. They argue only that this justification

is insufficient as a matter of law. Plaintiffs fail in their attempt to make this showing.

After noting that the uniformity clause provides similar but even greater protection than that provided by the federal equal protection clause, plaintiffs rely heavily upon the United States Supreme Court case of *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 84 L. Ed. 2d 751, 105 S. Ct. 1676 (1985), a federal equal protection clause case, in their attempt to show that section 409 violates the uniformity clause as a matter of law. Plaintiffs submit that *Ward* controls this case because there the Court "rejected precisely the same justification that defendants have offered here in support" of the premium tax classification. They maintain that *Ward* renders section 409 unconstitutional on its face, because it leaves no possible room for upholding that section. Plaintiffs' argument must be rejected, for the reasons explained below.

Proper understanding of *Ward* requires a brief description of the landmark case which preceded it, *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648, 68 L. Ed. 2d 514, 101 S. Ct. 2070 (1981). In *Western & Southern*, a foreign insurance company challenged as violative of the federal equal protection clause a California statute which imposed a retaliatory tax on foreign insurers whose home states imposed a discriminatory tax on California insurers doing business within their borders.[3] The Court explicitly held, for the first

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[3] The plaintiff also challenged the tax as violative of the commerce clause. The Court rejected this argument, noting that "Congress removed all Commerce Clause limitations on the authority of the States to regulate and tax the business of

time, that a state may not impose "more onerous taxes or other burdens on foreign corporations than those imposed on domestic corporations, unless the discrimination between foreign and domestic corporations bears a rational relation to a legitimate state purpose." *Western & Southern*, 451 U.S. at 668, 68 L. Ed. 2d at 530, 101 S. Ct. at 2083. In other words, the Court established that a tax classification based on corporate domicile will be sustained if it is found to be "rationally related to achievement of a legitimate state purpose." *Western & Southern*, 451 U.S. at 657, 68 L. Ed. 2d at 523, 101 S. Ct. at 2077. The Court promulgated a two-part inquiry to be used in making this determination: "(1) Does the challenged legislation have a legitimate purpose? and (2) Was it reasonable for the lawmakers to believe that use of the challenged classification would promote that purpose?" *Western & Southern*, 451 U.S. at 668, 68 L. Ed. 2d at 531, 101 S. Ct. at 2083. Ultimately, the Court sustained California's retaliatory tax classification. The Court held that California's purpose in enacting the tax – to promote the interstate business of its domestic insurers by deterring other states from enacting discriminatory or excessive taxes against them – was legitimate, and that California lawmakers reasonably could have believed that imposing the retaliatory tax would promote this purpose. *Western & Southern*, 451 U.S. at 668-74, 68 L. Ed. 2d at 531-35, 101 S. Ct. at 2083-86.

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insurance when it passed the McCarran-Ferguson Act [citation], as this court acknowledged in *State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451, 452[, 8 L. Ed. 2d 620, 622, 82 S. Ct. 1380, 1381] (1962)." *Western & Southern*, 451 U.S. at 653, 68 L. Ed. 2d at 520, 101 S. Ct. at 2075.

A short time later, in *Ward*, 470 U.S. 869, 84 L. Ed. 2d 751, 105 S. Ct. 1676, the Court reaffirmed the principles established in *Western & Southern*, while clarifying their application. There, a group of foreign insurance companies brought a federal equal protection challenge against an Alabama statute that imposed a higher gross premiums tax on foreign insurance companies than on domestic insurance companies. The Alabama trial court sustained the tax classification as rationally related to the state purposes of (1) encouraging the formation of new insurance companies in Alabama, and (2) encouraging capital investments in certain Alabama assets by foreign insurance companies. A state appellate court agreed, but found that there were unresolved factual issues as to whether the statutory classification was rationally related to these purposes. To avoid delay, the plaintiffs stipulated that a rational relationship was present and sought review as to the legitimacy of the two purposes relied upon by the Alabama court. The Supreme Court determined that, given the procedural posture of the case, the only question properly before it was whether the two purposes approved by the Alabama courts were legitimate. *Ward*, 470 U.S. at 875 & n.5, 84 L. Ed. 2d at 757-58 & n.5, 105 S. Ct. at 1680 & n.5.

The Court concluded that neither purpose was legitimate under the circumstances of that case. *Ward*, 470 U.S. at 882-83, 84 L. Ed. 2d at 762, 105 S. Ct. at 1684. The Court held that the promotion of domestic industry was not a legitimate state purpose for imposing the tax because such an aim "is purely and completely discriminatory, designed only to favor domestic industry within the State, no matter what the cost to foreign corporations also

seeking to do business there." *Ward*, 470 U.S. at 878, 84 L. Ed. 2d at 759, 105 S. Ct. at 1681. As to the second purpose, to encourage capital investments in certain Alabama assets, the Court determined that this purpose was also illegitimate because domestic insurers remained entitled to a more favorable rate of taxation regardless of whether they invested in Alabama assets or not, while foreign insurers could never completely eliminate the tax regardless of how much they invested. The Court found this disparity to demonstrate that the statute's classification was impermissibly "based solely on residence." *Ward*, 470 U.S. at 882-83, 84 L. Ed. 2d at 762, 105 S. Ct. at 1684. The Court emphasized that its holdings meant only that states may not impose discriminatorily higher taxes on nonresident corporations "solely because they are nonresidents." *Ward*, 470 U.S. at 882 n.10, 84 L. Ed. 2d at 762 n.10, 105 S. Ct. at 1684 n.10. Significantly, although the Court found the two purposes before it to be illegitimate, the Court remanded the cause to the Alabama courts for consideration of other purposes that might sustain the premium tax classification. *Ward*, 470 U.S. at 875 n.5, 84 L. Ed. 2d at 758 n.5, 105 S. Ct. at 1680 n.5. The Court explained that where a legitimate state purpose is found, then "the state law stands as long as the burden it imposes is found to be rationally related to that purpose, a relationship that is not difficult to establish." *Ward*, 470 U.S. at 881, 84 L. Ed. 2d at 761, 105 S. Ct. at 1683.

The dissent in *Ward* claimed that the tax classification at issue should be sustained on other bases, including that it addresses the legitimate state concern that foreign insurers are more difficult to regulate so as to safeguard their solvency than are domestic insurers. *Ward*, 470 U.S.

at 888, 891-93, 84 L. Ed. 2d at 766, 768-69, 105 S. Ct. at 1687, 1688-89 (O'Connor, J., dissenting, joined by Brennan, Marshall, and Rehnquist, JJ.). In response, the Court majority emphasized that this case "does not involve or question, as the dissent suggests, [citation], the broad authority of a State to promote and regulate its own economy." *Ward*, 470 U.S. at 882 n.10, 84 L. Ed. 2d at 762 n.10, 105 S. Ct. at 1684 n.10. The Court majority thus plainly explained that it did not consider the legitimacy of any other purpose to be before it, particularly those addressed by the dissent.

As noted above, plaintiffs contend that *Ward* controls this case because there the Court "rejected precisely the same justification that defendants have offered here in support" of the premium tax classification. This argument misrepresents *Ward*'s holdings. Most fundamentally, the *Ward* majority did not address the legitimacy of the purpose being advanced here for sustaining the tax classification: *i.e.*, to promote effective state regulation of the insurance industry in order to protect the state's policyholders from insurer insolvency. Although in *Ward* the State of Alabama did argue a similar purpose to the Supreme Court, and in the process persuaded four dissenting justices that its tax statute could be upheld on this ground without further proceedings, this purpose clearly was not ruled upon by the Court majority. The majority left for consideration on remand the legitimacy of all purposes other than the two it found to be properly before it. Therefore, despite plaintiffs' vehement protestations to the contrary, *Ward* does not resolve this case.

This court must look beyond *Ward* to determine whether Illinois' premium tax statute violates the equal

protection clause, or the Illinois uniformity clause, on its face. The Supreme Court's holdings in *Ward* were subsequently elaborated on in *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System,* 472 U.S. 159, 86 L. Ed. 2d 112, 105 S. Ct. 2545 (1985). There, the states of Massachusetts and Connecticut permitted acquisition of local banks by out-of-state bank holding companies, but only if those companies were headquartered in New England and not controlled by companies headquartered in other states. Federal law authorized such limitations and applied them to national banks located in those states. Companies headquartered outside New England challenged the state laws as violative of, *inter alia,* the federal equal protection clause, but the Supreme Court sustained them.

In distinguishing *Ward,* the Court quoted its statement that the equal protection clause prohibited state economic regulation only if " 'accomplished by imposing discriminatorily higher taxes on nonresident corporations *solely* because they are nonresidents.' " (Emphasis added.) *Northeast Bancorp, Inc.,* 472 U.S. at 177, 86 L. Ed. 2d at 127, 105 S. Ct. at 2555, quoting *Ward,* 470 U.S. at 882 n.10, 84 L. Ed. 2d at 762 n.10, 105 S. Ct. at 1684 n.10. The Court explained that *Ward* determined that "encouraging the formation of new domestic insurance companies within a State and encouraging capital investment in the State's assets and governmental securities were not, *standing alone,* legitimate state purposes which could permissibly be furthered by discriminating against out-of-state corporations in favor of local corporations." (Emphasis added.) *Northeast Bancorp, Inc.,* 472 U.S. at 177, 86 L. Ed. 2d at 127, 105 S. Ct. at 2555. Returning to the

case before it, the Court then pointed to traditional state interests in local control of banking to "preserve a close relationship between those in the community who need credit and those who provide credit." *Northeast Bancorp, Inc.*, 472 U.S. at 178, 86 L. Ed. 2d at 127, 105 S. Ct. at 2555. Allowing interstate banking only on a regional basis preserved such relationships to some extent while obtaining the benefits of increasing the number of banking competitors. Allowing immediate acquisition of local banks by companies headquartered outside New England would threaten the independence of local banking institutions. The Court explained that these purposes were different from the purposes rejected in *Ward. Northeast Bancorp, Inc.*, 472 U.S. at 178, 86 L. Ed. 2d at 127-28, 105 S. Ct. at 2555. *Northeast Bancorp* thus makes clear that a state may discriminate against nonresident corporations so long as it does not do so solely because they are nonresidents. Consequently, if the discrimination between foreign and domestic companies bears a rational relationship to *any* legitimate state purpose, then it is permissible under the equal protection clause.

More recently, the Supreme Court of Florida in *Gallagher v. Motors Insurance Corp.*, 605 So. 2d 62 (Fla. 1992), *cert. dismissed*, 506 U.S. 1074, 122 L. Ed. 2d 179, 113 S. Ct. 1036 (1993), upheld as constitutional under the federal equal protection clause a state insurance premium tax statute similar to the statute challenged here. Like the statutory scheme here at issue, under the Florida statute, foreign insurance companies were taxed at a higher rate than domestic companies and, regardless of the actions taken by a foreign company, it could never reduce the tax to the level paid by domestic companies. The Supreme

Court of Florida, applying the test set forth in *Western & Southern* and elaborated on in *Ward* and *Northeast Bancorp, Inc.*, determined that Florida's asserted purpose for enacting its premium tax-Florida's desire to gain greater regulatory control over foreign insurance companies – was legitimate, and that Florida's legislature reasonably could have believed that imposing the premium tax on foreign insurers would promote this objective. *Gallagher,* 605 So. 2d at 66-70. The court therefore upheld Florida's premium tax statute even though it discriminated against nonresident corporations because it did not do so solely because they are nonresidents. Florida's discrimination as between the foreign and domestic insurance companies bore a rational relationship to the legitimate state purpose of gaining greater regulatory control over insurance companies.

Because the Florida and Illinois statutes are so similar, and because Florida officials were asserting a regulatory justification for their statute virtually identical to that posed here by Illinois officials, I find the *Gallagher* analysis to be instructive. Like the court in *Gallagher,* I would hold that Illinois' objective of gaining greater regulatory control over foreign insurers in order to protect Illinois policyholders from insurer insolvency is a legitimate state purpose for Illinois' premium tax classification. Similarly, I would also hold that the Illinois General Assembly, like the Florida legislature, reasonably could have believed that imposing the premium tax on foreign insurers would promote Illinois' objective of gaining greater regulatory control over foreign insurers in order to protect Illinois policyholders from insurer insolvency. I

would therefore conclude that no equal protection violation has been established by plaintiffs.

As noted above, plaintiffs rely on *Ward* in their attempt to establish a uniformity clause violation. Plaintiffs' erroneous assertion that *Ward* controls this case does not satisfy their heavy burden of persuasion in this regard.

Besides *Ward*, plaintiffs cite six other cases in their attempt to show that defendants' regulatory justification is insufficient as a matter of law, thereby establishing a uniformity clause violation. None of these cases, however, supports plaintiffs' claim that Illinois' premium tax classification lacks a reasonable relationship to the asserted regulatory justification as a matter of law.

Searle Pharmaceuticals, Inc. v. Department of Revenue, 117 Ill. 2d 454 (1987), *Commercial National Bank v. City of Chicago*, 89 Ill. 2d 45, 72-73 (1982), and *Winter v. Barrett*, 352 Ill. 441, 461-63 (1933), are all inapposite to the case at bar because in those cases this court concluded that there was no real and substantial difference between the two classes of taxpayers being subjected to different tax rates. Here, in contrast, the majority and I agree that the premium tax classification is based upon the real and substantial difference between foreign and domestic insurance companies of Illinois' disparate regulatory powers over them.

The last three cases cited by plaintiffs did not even consider the issue of whether any difference between foreign and domestic insurance companies could justify differences in taxation. *National-Ben Franklin Fire Insurance Co. v. Brenza*, 411 Ill. 337 (1952); *People v. Concordia*

Fire Insurance Co., 350 Ill. 365 (1932), *modified*, 292 U.S. 535, 78 L. Ed. 1411, 54 S. Ct. 830 (1934); *Hanover Fire Insurance Co. v. Harding*, 327 Ill. 590 (1927), *on remand from* 272 U.S. 494, 71 L. Ed. 372, 47 S. Ct. 179 (1926), *rev'g* 317 Ill. 366 (1925). This is not surprising given that these cases were all grounded upon *Hanover Fire Insurance Co. v. Harding*, 272 U.S. 494, 71 L. Ed. 372, 47 S. Ct. 179 (1926), a decision handed down decades before the Court in *Western & Southern* clarified the proper test to be used in deciding equal protection challenges based on corporate domicile. See *Western & Southern*, 451 U.S. at 657-68, 68 L. Ed. 2d at 523-30, 101 S. Ct. at 2077-83 (discussing development of law). These cases are thus not dispositive of the present case.

In light of plaintiffs' failure to establish that defendants' regulatory justification is insufficient as a matter of law, the majority seriously errs in striking its deathblow to Illinois' premium tax statute. I would conclude that the premium tax statute survives plaintiffs' uniformity clause challenge. The majority, however, concludes otherwise and gives four reasons for its determination that the premium tax classification does not bear a reasonable relationship to Illinois' regulatory efforts, as a matter of law. The majority's rationale does not withstand scrutiny.

The majority first states that the premium tax classification lacks a reasonable relationship to Illinois' regulatory efforts because foreign insurance companies are already required to pay all expenses incurred by the Department in examining those companies (see 215 ILCS 5/132.4(d), 402, 408.3 (West 1992)). The majority neglects to mention that all insurance companies, not just foreign ones, are required to pay the Department's regulatory

expenses. Regardless, I fail to see how requiring insurance companies to pay certain regulatory expenses operates to make the premium tax classification unconstitutional under the uniformity clause. Neither plaintiffs nor the majority opinion cites any authority for this unique proposition. I reject it as unsound. The constitutionality of a tax classification cannot be made to depend on what other statutory provisions require. This is because a legislative body, in drawing classifications, is entitled to adopt laws that "only partially ameliorate a perceived evil" (*City of New Orleans v. Dukes*, 427 U.S. 297, 303, 49 L. Ed. 2d 511, 517, 96 S. Ct. 2513, 2517 (1976)). Here, our General Assembly reasonably could have believed that the Insurance Code provision imposing the premium tax and those provisions imposing payment of regulatory expenses each partially work to aid Illinois in its efforts to regulate insurance companies. This exercise of legislative judgment does not offend the uniformity clause of the Illinois Constitution.

The majority next determines that the premium tax classification lacks a reasonable relationship to Illinois' regulatory efforts because "simply collecting" the tax from foreign companies does not act to bestow the desired regulatory powers upon the Department. This court, however, has never suggested that the asserted justification for the legislature's statutory classification must be proven to in fact promote the legislative objective in order to satisfy the uniformity clause. To the contrary, our opinions have consistently held that all the uniformity clause requires is that the nonproperty tax classification bear "a reasonable relationship" to the legislative

objective or to public policy. See, *e.g., Searle Pharmaceuticals, Inc. v. Department of Revenue,* 117 Ill. 2d 454, 468 (1987). This test has been met here. The General Assembly reasonably could have believed that providing a tax incentive to encourage foreign insurance companies to make Illinois their corporate domicile would promote Illinois' objective of gaining greater regulatory control over those insurers, thereby providing greater protection to Illinois policyholders from insurer insolvency. This court should not act to replace the General Assembly's judgment in this matter with its own. The majority's approach disregards the well-settled principle that courts must defer to legislative judgment in drawing a classification if any "state of facts can reasonably be conceived that would sustain the classification." *Allegro Services, Ltd.,* 172 Ill. 2d at 251.

Thirdly, the majority objects to the premium tax classification as unreasonable because "[f]oreign companies which meet all of the recordkeeping and business requirements of section 409(4) * * * must nevertheless pay the * * * tax." 179 Ill. 2d at 103. In doing so, the majority again fails to apply the dispositive test. The premium tax classification, which is based on the real and substantial difference between the regulatory powers Illinois has over foreign and domestic insurance companies, must here be sustained so long as it bears some reasonable relationship to the legislative purpose of increasing Illinois' regulatory control over the insurance industry. As discussed above, the classification meets this requirement. It is therefore irrelevant that foreign companies which meet all of the other exemption requirements are nonetheless required to pay the tax.

Finally, the majority asserts that assessing the premium tax on foreign insurance companies is not reasonably related to protecting the interests of Illinois policyholders because "the tax is imposed on all foreign companies regardless of their financial strength or their level of compliance with the requirements of section 409(4)" (179 Ill. 2d at 103) and, furthermore, "an irresponsible foreign company has a strong incentive to escape such Illinois regulation indefinitely by merely continuing to pay the privilege tax and remaining incorporated outside of Illinois" (179 Ill. 2d at 103). Once again, the majority's rationale cannot be made to comport with prior precedent of this court. In *Geja's Cafe v. Metropolitan Pier & Exposition Authority*, 153 Ill. 2d 239 (1992), a tax was imposed on food and beverage sales in restaurants located in certain geographical areas of the City of Chicago in order to fund expansion of a city convention center. The plaintiff restaurants and patrons challenged the geographical tax classifications as being drawn "either too small or too big," for various reasons. *Geja's Cafe*, 153 Ill. 2d at 249. This court rejected the plaintiffs' challenge, stating:

> "Plaintiffs' arguments boil down to mere assertions that they can draw better taxing lines than the General Assembly. However, in a uniformity clause challenge the court is not required to have proof of perfect rationality as to each and every taxpayer. The uniformity clause was not designed as a straightjacket for the General Assembly. Rather, the uniformity clause was designed to enforce minimum standards of reasonableness and fairness as between groups of taxpayers." *Geja's Cafe*, 153 Ill. 2d at 252.

Like the plaintiffs in *Geja's Cafe*, the majority here objects to the taxing classification drawn by the General Assembly by arguing that the classification does not always make sense if one considers the circumstances of a particular foreign company ("the tax is imposed on all foreign companies regardless of their financial strength or their level of compliance with the requirements of section 409(4)" and "an irresponsible foreign company" can nonetheless escape the desired regulation by choosing to pay the tax (179 Ill. 2d at 103)). This court should reject such reasoning, as we did in *Geja's Cafe*. As we stated there, a court "is not required to have proof of perfect rationality as to each and every taxpayer" in order to sustain a tax as constitutional under the uniformity clause. *Geja's Cafe*, 153 Ill. 2d at 252. This court should therefore adhere to our prior decision in *Geja's Cafe*, which recognized that in conducting uniformity clause review this court is limited to determining whether the classification actually drawn by the legislature meets the uniformity clause's standard of reasonableness and fairness as between groups of taxpayers.

In conclusion, plaintiffs have failed to establish that defendants' asserted regulatory justification for the premium tax classification is insufficient as a matter of law. Therefore, plaintiffs have failed to meet their burden of persuasion and, as a result, the classification should be upheld by this court as withstanding their uniformity clause challenge.

II. Equal Protection Clauses

This court has determined that if a tax is constitutional under the uniformity clause, then it " 'inherently fulfills the requirements of the equal protection clause.' " *Allegro Services, Ltd.*, 172 Ill. 2d at 250, quoting *Geja's Cafe*, 153 Ill. 2d at 247. Accordingly, having found the premium tax to withstand plaintiffs' uniformity clause challenge, I would also find it to withstand plaintiffs' challenge under the Illinois and United States equal protection clauses.

III. Conclusion

Plaintiffs have failed to establish that the premium tax classification violates either the uniformity clause of the Illinois Constitution or the equal protection clauses of the United States and Illinois Constitutions. Therefore, the summary judgment granted to plaintiffs should be reversed.

CHIEF JUSTICE FREEMAN and JUSTICE McMORROW join in this dissent.

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT, LAW DIVISION
TAX AND MISCELLANEOUS REMEDIES DIVISION

MILWAUKEE SAFEGUARD INSURANCE COMPANY, et al.,	)	
Plaintiffs,	)	
	)	No. 93 L 50663
v.	)	and all related
STEPHEN F. SELCKE, et al.,	)	case numbers
Defendants.	)	

MEMORANDUM AND DECISION

This case is before the court upon Plaintiffs' request for Partial Summary Judgment based upon the unconstitutionality of Section 409 of the Illinois Insurance Code. 215 ILCS 5/409 (1992).

Plaintiffs in this case are insurance companies incorporated in states other than Illinois and conducting insurance business within Illinois. (Brief in Support of Plaintiffs' Motion for Partial Summary Judgment at 1 ("Plaintiffs' Brief")). Defendants are the Director of the Illinois Department of Insurance and the Treasurer of the State of Illinois. (Plaintiffs' Brief at 2).

As foreign companies under the Illinois Insurance Code, 215 ILCS 5/2(g), each Plaintiff made payments of the Annual Privilege Tax of 215 ILCS 5/409 to the Illinois Department of Insurance under protest. (Plaintiffs' Brief at 2). Plaintiffs subsequently filed timely complaints and obtained injunctions under the Protest Act. (Plaintiffs' Brief at 2).

STATEMENT OF FACTS

Under the Illinois Insurance Code, a foreign insurance company "means a company incorporated or organized under the laws of any state of the United States other than this state." 215 ILCS 5/2(g). A domestic insurance company "means a company incorporated or organized under the laws of this state." Under §409(1) of the Insurance Code, Illinois requires that:

> (1) Every foreign or alien company doing an insurance business in this State, except fraternal benefit societies, shall, for the privilege of doing business in this State by renewal of certificate of authority as provided in Section 114, pay to the Director for the State treasury a State tax equal to 2 per cent of the net taxable income, together with any amounts due under Section 144.

215 ILCS 5/409(1).

Domestic insurance companies are also required to pay the privilege tax unless they meet the requirements of §409(4):

> (4) A domestic company must pay the State tax in subsection (1) unless:
>
> (a) it maintains its principal place of business in this State; and
>
> (b) it maintains in this State officers and personnel knowledgeable of and responsible for the company's operation, books, records, administration and annual statement;
>
> (c) it conducts in this State substantially all of its underwriting, policy issuing, and serving operations relating to Illinois policy holders and certificate holders; and

> (d) it complies with §133(2) of this Code (requiring books to be made available for inspection and to hold its investment securities in Illinois).

215 ILCS 5/409(4).

According to Defendants, wholly-owned Illinois subsidiaries of foreign companies are also exempt if the subsidiaries meet the §409(4) requirements. (Arnold Dutcher's Affidavit, Paragraphs 3-6). The wholly owned Illinois subsidiaries may transfer business written through the subsidiary to the foreign parent company. (Arnold Dutcher's 2nd Affidavit, paragraphs 21-22).

Plaintiffs argue they are entitled to Partial Summary Judgment based upon §409's unconstitutional distinction between foreign and domestic insurance companies. Plaintiffs contend that §409 violates the Uniformity Clause of the Illinois Constitution and the Equal Protection Clauses of the Illinois and United States Constitutions because on its face it exempts domestic companies meeting the §409(4) requirements while requiring all foreign companies to pay the Privilege Tax regardless of whether or not they meet the same requirements. (Plaintiffs' Brief).

Defendants argue that §409 is not unconstitutional under the Uniformity Clause or the Equal Protection Clauses. Defendants contend that there are real and substantial differences between foreign companies who are taxed and the domestic companies exempt from the tax. (Defendants' Supplemental Response to Plaintiffs' Motion for Partial Summary Judgment at 8). Defendants also argue that Illinois's regulatory concerns provide a

rational basis for §409 thereby precluding judgment for Plaintiffs on equal protection grounds. *Id.* at 9-10. Defendants further contend that factual development is necessary to show whether Plaintiffs are similarly situated to exempt companies and whether Plaintiffs actually conduct their business in compliance with the §409(4) requirements. *Id.* at 8.

ISSUES PRESENTED

I. Whether §409 of the Illinois Insurance Code, which imposes a Privilege Tax on all "Foreign" insurance companies, violates the Uniformity Clause of the Illinois Constitution, Article IX, Section 2.

II. Whether §409 of the Illinois Insurance Code, which imposes a Privilege Tax on all "Foreign" insurance companies, violates the Equal Protection Clauses of the Illinois Constitution, Article I, Section 2 and of the Fourteenth Amendment of the United States Constitution.

DECISION OF THE COURT

Summary judgment is proper where there is no genuine issue as to any material fact and the issue can be decided as a matter of law. *First of America v. Netsch* (1995), 155 Ill. 2d 165, 176. Partial summary judgment is appropriate where "there is no material factual dispute as to any major issue even if substantial controversy exists with respect to other issues." *Gleicher v. University of Health Sciences* (1991) 224 Ill. App. 3d, 77, 87 (1st Dist.).

Plaintiffs seek partial summary judgment on the basis of the unconstitutionality of §409 of the Illinois

Insurance Code. The power of the legislature to make tax classifications is very broad. *National Realty & Investment Co. v. Department of Revenue* (1986), 144 Ill. App. 3d 541, 550 (2d Dist.). However, where a statute is unconstitutional, a court is under a duty to declare the statute invalid. *Wilson v. Department of Revenue* (1996), 169 Ill. 2d 306.

In construing a statute "the court must ascertain and effectuate the overall intent of the drafters. Intent is best determined initially by the plain and ordinary meaning of the language itself. If the language is clear and unambiguous, the court must enforce the law as enacted, without employing extrinsic aids to construction." *Villegas v. Board of Fire & Police Comm'rs* (1994), 266 Ill. App. 3d 202, 209 (2d Dist.). Even if a statute is applied in a constitutional fashion, it is invalid if unconstitutional on its face. *Id.* at 210. A trial court may rule on the constitutionality of legislation on the basis of pre-trial motions. *See Communications & Cable Company of Chicago, Inc., et al. v. City of Chicago,* No. 1-95-4358 (Ill. App. Ct. 1st Dist., July 12, 1996); *Rodgers, et al. v. Whitley,* No. 1-93-4338 (Ill. App. Ct. 1st Dist., July 8, 1996); *Lou Owen Inc. v. Village of Schaumburg* No. 1-95-0157 (Ill. App. Ct. 1st Dist., April 26, 1996).

I.

The Uniformity Clause of the Illinois Constitution requires that differences in tax treatment be based upon real and substantial differences between those who are taxed and those who are not taxed and that the reason is rationally related to a legitimate state objective. *Geja's Cafe v. Metropolitan Pier Expo. Auth.* (1992), 153 Ill. 2d 239;

Searle Pharm., Inc. v. Department of Revenue (1987), 117 Ill. 2d 454. When a plaintiff presents a good faith uniformity challenge to a tax, the taxing body must provide a justification for the classification. *Communications & Cable of Chicago, Inc., et al. v. City of Chicago,* No. 1-95-4358, slip op. at 17 (Ill. App. Ct. 1st Dist., July 12, 1996). The plaintiff then must persuade the court that the reason is insufficient as a matter of law or unsupported by the facts. *Id.* Taxes must be imposed equally upon all persons participating in a particular business activity or transaction. *Winter v. Barrett* (1933), 352 Ill. 441; *Commercial National Bank of Chicago v. City of Chicago* (1982), 89 Ill.2d 45.

Under §409 of the Insurance Code, companies incorporated in Illinois and meeting the §409(4) requirements are exempt from paying the annual privilege tax. In contrast, a foreign company meeting the §409(4) requirements is not exempt from paying the annual privilege tax. Therefore, foreign companies who conduct their insurance business in compliance with the requirements of §409(4) are taxed differently from domestic insurance companies complying with §409(4).

Defendants argue that the Plaintiffs' motion cannot be granted because the Defendants' opposing affidavit establishes the existence of disputed material facts. (Defendants' Supplemental Response to Plaintiffs' Motion for Partial Summary Judgment at 6). Defendants claim that foreign insurance companies can avoid paying the Privilege Tax by complying with the §409(4) requirements. (Defendants' Supplemental Response at 6; Arnold Dutcher's 2nd Affidavit, paragraphs 3-6; Arnold Dutcher's Affidavit paragraphs 21 and 22). Plaintiffs do

not dispute the fact that foreign companies may conduct insurance business through wholly owned Illinois subsidiaries meeting the §409(4) requirements thereby avoiding the Privilege Tax. (Reply to Defendants' Response to Plaintiff's Motion for Partial Summary Judgment at 3-4). However, this fact is immaterial to the issue of the constitutionality of the statute directed towards foreign corporations.

Defendants contend that a parent foreign corporation and an Illinois incorporated wholly-owned subsidiary are not separate entities under the Illinois Insurance Code and that, therefore, there are foreign corporations who do not pay the Privilege Tax. Oral Argument Transcript, Dec. 6, 1995, at 21-25. However, this contention is not borne out by either basic corporation law or the Illinois Insurance Code.

According to basic corporation law, a subsidiary is a corporation "controlled by *another* corporation by reason of the latter's ownership of at least a majority of shares of stock." 18 Am. Jur. 2d §34 (1985) (emphasis added). Subsidiaries are treated as separate entities. 18 Am. Jur. 2d §55 (1985). The Illinois Insurance Code does not depart from this definition. The "Holding Company Act" of the Insurance Code to which Defendants refer defines an "insurance company holding system" as "two or more affiliated persons, one or more of which is an insurance company." 215 ILCS 5/1.31.1 (c). "Person" is defined as "an individual, a corporation . . . " 215 ILCS 5/1.31.1 (e). A "subsidiary of a specified person is an affiliate controlled by such person directly or indirectly through one or more intermediates." 215 ILCS 5/1.31.1 (g). Clearly, reading the definitions together, the Holding Company

Act regards the members of a holding company system as separate entities. While an Illinois wholly-owned subsidiary may be able to transfer business to its parent foreign company, this does not render the parent and subsidiary one entity.

Section 409 distinguishes between foreign companies meeting the §409 (4) requirements and domestic companies meeting the §409 (4) requirements. A foreign company, doing business as a foreign company and not through an Illinois subsidiary, on the face of the statute can never be exempt from the privilege tax while a similarly situated Illinois insurance company is exempt. *See* 215 ILCS 5/409. The statute distinguishes merely on the basis of site of incorporation. On its face, there is no other difference between a foreign company meeting the §409 (4) requirements and a domestic company meeting the §409 (4) requirements except the location of incorporation. Furthermore, the basic requirements for incorporation, as evidenced by articles of incorporation, are essentially identical from state to state. *See, e.g.*, Cal. Corp. Code §202 (Deering 1977); Del. Code Ann. tit. 8, §102 (1989); 805 ILCS 5/2.10 1992).

Defendants claim Illinois faces a greater regulatory burden with foreign insurance companies justifying the Privilege Tax. (Defendants' Motion for Summary Judgment; Arnold Dutcher's 2nd Affidavit). However, if an insurance company, foreign or domestic, can meet the §409(4) requirements, these concerns over regulatory burdens are met. There is no real and substantial difference between a foreign company and a domestic company meeting the §409(4) requirements. Requiring that an insurance company be incorporated in Illinois in order to

be eligible for exemption of the Privilege Tax is not rationally related to any real and substantial difference between a foreign company meeting the §409(4) requirements and a domestic company meeting the §409(4) requirements.

Therefore, §409 of the Illinois Insurance Code violates the Uniformity Clause of the Illinois Constitution on its face.

II.

Section 409 also violates the Equal Protection Clauses of the Illinois and United States Constitution. In analyzing Equal Protection questions dealing with the power to tax, Illinois courts interpret the Illinois and United States Constitutions as imposing the same limits. *See Searle Pharm., Inc. v. Department of Revenue* (1987) Ill.2d 454, 464-66. While a state may exclude foreign companies from its jurisdiction, once it admits foreign companies it cannot discriminate between foreign and domestic companies unless the discrimination bears a rational relationship to a legitimate state purpose. *Metropolitan Life Ins. Co. v. Ward* (1985), 470 U.S. 869, 875.

In *Hanover Fire Insurance Co. v. Harding*, (1926), 272 U.S. 494, the U.S. Supreme Court held that once a state licenses a corporation to do business within the state, the state may not impose a discriminatory tax on the grounds that the tax is for the continuing privilege of doing business in the state. *Id.* at 510-11. Therefore, any privilege tax imposed upon the foreign insurance companies authorized to do business in Illinois must have a rational basis

besides taxing for the mere privilege of continuing to do business in the state.

As discussed in I. above, §409 discriminates between foreign and domestic insurance companies on the sole basis of the state of incorporation. While a "foreign" vs. "domestic" distinction generally is not necessarily discriminatory, in the §409 application, the distinction bears no rational relationship to legitimate state objectives. In *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserves System,* (1985), 472 U.S. 159, the U.S. Supreme court upheld Massachusetts and Connecticut laws favoring New England incorporated banks over non-New England domiciled banks on the basis that the distinction aided bank regulation. However, discrimination on the basis of incorporation to encourage in-state incorporation for the purpose of promoting domestic business is not a legitimate state purpose. *Metropolitan Life Insurance Co. v. Ward* (1985), 470 U.S. 869, 878.

Defendants argue that the increased regulatory burdens posed by foreign companies provides the state with a legitimate purpose for discrimination between foreign and domestic companies. However, even if foreign companies meet the §409 (4) requirements addressing the State's regulatory concerns, they are not exempt from the Privilege Tax. Furthermore, the Insurance Code already requires a company being examined by the Department of Insurance to pay expenses incurred in any performance examination. 215 ILCS 5/408 (3). Therefore, a foreign insurance company meeting the §409 (4) requirements would, in effect, be assessed twice. First, the foreign insurance company would be required to pay the expenses for any performance examination. Second,

the foreign company would be required to pay the Privilege Tax justified by Defendants as necessary because of the difficulty and expense of regulating foreign companies. (Defendants' Supplemental Response at 9-10.)

Defendants argue that all foreign companies do not pay the tax because they can conduct their business through Illinois subsidiaries. Defendants contend that further factual development is necessary to determine whether all foreign companies are taxed and to determine "what the terms 'foreign' and 'domestic' actually mean for purposes of determining whether the statute unconstitutionally discriminates between such companies." (Defendants' Supplemental Response at 7). However, "when an act defines its own terms, it must be construed according to the definitions prescribed." *Villegas v. Board of Fire & Police Cmm'rs* (1994) 266 Ill. App. 3d 202, 211 (2d Dist.).

The Insurance Act defines a foreign company as one incorporated or organized under the laws of another state. 215 ILCS 5/2(g). The Act then clearly and unambiguously states "every foreign or alien company doing insurance business in this State, shall, for the privilege of doing business in this State . . . pay . . . a State tax equal to 2 per cent of the net taxable premium income . . . " 215 ILCS 5/409(1). There is nothing in the Act exempting foreign insurance companies, doing business as foreign companies and not through an Illinois subsidiary, from the Privilege Tax.

The facts in this case are closely analogous to the facts in *WHYY v. Glassboro.* (1968), 393 U.S. 117. New Jersey would not allow foreign corporations to show they

qualified under New Jersey law as non-profit corporations although domestic corporations had the opportunity to make this showing. *Id.* The U.S. Supreme Court held this was a violation of equal protection. *Id.* at 120.

In this case, domestic insurance companies are given the opportunity to demonstrate compliance with the § 409(4) requirements thereby avoiding the Privilege Tax. 217 ILCS 5/409(4). Foreign companies are denied this opportunity. 217 ILCS 5/409(1) & (4). This treatment violates the Equal Protection Clause.

Therefore, § 409 of the Illinois Insurance Code is unconstitutional in that it violates the Equal Protection Clauses of the Illinois and United States Constitutions.

ORDER

The parties are to draft an order consistent with this opinion.

ENTER:

JUDGE RANDYE A. KOGAN

AUG - 9 1996

Circuit Court-1509

Randye A. Kogan
Associate Judge

[SEAL]
SUPREME COURT OF ILLINOIS
SUPREME COURT BUILDING
SPRINGFIELD 62701
[Name And Address Omitted In Printing]

January 16, 2002

Ms. Mary Kay McCalla Martire
Foley & Lardner
Three First National Plaza
Suite 4100
Chicago, IL 60602

TODAY THE FOLLOWING ORDER WAS ENTERED:

No. 92483 –
Milwaukee Safeguard Insurance Company et al., petitioners, v. Stephen F. Selcke, etc., et al., respondents.

Motion by petitioners for stay of mandate pending the filing of a petition for writ of certiorari in the United States Supreme Court. Motion denied.

Order entered by the Court.

The mandate of this Court has issued forthwith to the Appellate Court, First District.

SUPREME COURT OF ILLINOIS

WEDNESDAY, DECEMBER 5, 2001

THE FOLLOWING CASES ON THE LEAVE TO APPEAL DOCKET WERE DISPOSED OF AS INDICATED:

* * *

No. 92483 – Milwaukee Safeguard Insurance Company et al., petitioners v. Stephen F. Selcke, etc., et al., respondents. Leave to appeal, Appellate Court, First District. (1-00-1973, 1-00-1979) Petition for leave to appeal denied.

* * *

RULE 29.6 STATEMENTS

None of the Petitioners are publicly held companies, and no publicly held company owns 10% or more of any of the Petitioners' stock. However, certain of the Petitioners are ultimately owned by publicly held companies, as follows:

Ultimate Ownership By Publicly held Company

Petitioner American Continental Insurance Company is a wholly-owned subsidiary of St. Paul Fire and Marine Insurance Company, which is a wholly-owned subsidiary of The St. Paul Companies, Inc., a publicly held company.

Petitioner American Continental Life Insurance Company is a wholly-owned subsidiary of CNA Group Life Assurance Company, which is a wholly-owned subsidiary of Continental Casualty Company, which is a wholly-owned subsidiary of CNA Financial Corp., a publicly held company. More than 10% of the stock of CNA Financial Corp. is owned by Loews Corporation, a publicly held company.

Petitioner Fortis Insurance Company is a wholly-owned subsidiary of Interfinancial, Inc., which is a wholly-owned subsidiary of Fortis of Belgium and The Netherlands, a publicly held company.

The ultimate parent corporation of the following Petitioners is General Motors Corporation, a publicly held company. The Petitioners listed below are wholly-owned subsidiaries of GMAC Insurance Holdings, Inc., which is a wholly-owned subsidiary of General Motors

Acceptance Corporation, which is a wholly-owned subsidiary of General Motors Corporation, a publicly held company:

CIM Insurance Corporation
MIC General Insurance Corporation
MIC Life Insurance Corporation
MIC Property and Casualty Insurance Corporation
Motors Insurance Corporation
National General Insurance Company

Petitioner Mortgage Guaranty Insurance Corporation is a wholly-owned subsidiary of MGIC Investment Corporation, a publicly held company.

Petitioner Northwestern National Casualty Company is a wholly-owned subsidiary of Northwestern National Holding Company, Inc., which is a wholly-owned subsidiary of American Reliance, Inc., which a wholly-owned subsidiary of Highlands Insurance Group, Inc., a publicly held company.

The ultimate parent of the following Petitioners is Citigroup, Inc., a publicly held company, as follows:

Petitioners Farmington Casualty Company, Travelers Casualty and Surety Company of America, Travelers Casualty Company of Connecticut, and Travelers Commercial Insurance Company are wholly-owned subsidiaries of Petitioner Travelers Casualty and Surety Company, which is a wholly-owned subsidiary of Travelers Property Casualty Corp., which is a wholly-owned subsidiary of The Travelers Insurance Group, Inc., which is a wholly-owned subsidiary of Citigroup, Inc., a publicly held company.

Petitioners The Charter Oak Fire Insurance Company, The Phoenix Insurance Company, The Travelers Indemnity Company of Connecticut, and The Travelers Home and Marine Insurance Company are wholly-owned subsidiaries of Petitioner The Travelers Indemnity Company, which is a wholly-owned subsidiary of Travelers Property Casualty Corp., which is a wholly-owned subsidiary of The Travelers Insurance Group, Inc., which is a wholly-owned subsidiary of Citigroup, Inc., a publicly held company.

Petitioner The Automobile Insurance Company of Hartford, Connecticut is a wholly-owned subsidiary of Petitioner The Standard Fire Insurance Company, which is a wholly-owned subsidiary of Travelers Property Casualty Corp., which is a wholly-owned subsidiary of The Travelers Insurance Group, Inc., which is a wholly-owned subsidiary of Citigroup, Inc., a publicly held company.

Petitioner The Travelers Life and Annuity Company is a wholly-owned subsidiary of The Travelers Insurance Company – Life Department, which is a wholly-owned subsidiary of The Travelers Insurance Group, Inc., which is a wholly-owned subsidiary of Citigroup, Inc., a publicly held company.

The ultimate parent corporation of the following Petitioners is Unitrin, Inc., a publicly held company. The Petitioners listed below are wholly-owned subsidiaries of Trinity Universal Insurance Company, which is a wholly-owned subsidiary of Unitrin, Inc., a publicly held company:

Alpha Property and Casualty Insurance Company
Milwaukee Casualty Insurance Company
Milwaukee Safeguard Insurance Company

Petitioner VASA North Atlantic Insurance Company, now known as Centris Insurance Company, is a wholly-owned subsidiary of HCC Life Insurance Company, which is a wholly-owned subsidiary of HCC Insurance Holdings, Inc., a publicly held company.

Petitioner Wisconsin Mortgage Assurance Corporation, now known as MGIC Indemnity Corporation, is a wholly-owned subsidiary of Mortgage Guaranty Insurance Corporation, which is a wholly-owned subsidiary of MGIC Investment Corporation, a publicly held company.

Ultimate Ownership By Non-Publicly Traded Company

Petitioner National American Insurance Company is a wholly-owned subsidiary of Chandler (U.S.A.), Inc. which is not a publicly held company.

Mutual Insurance Companies

The following Petitioners are mutual insurance companies with no parent corporation and no stock outstanding:

American Family Mutual Insurance Company
Auto-Owners Insurance Company
Church Mutual Insurance Company
CUNA Mutual Insurance Society
Employers Insurance of Wausau A Mutual Company
Graphic Arts Mutual Insurance Company
Liberty Mutual Fire Insurance Company
Milwaukee Mutual Insurance Company
Mutual Service Casualty Insurance Company
Nationwide Mutual Insurance Co.
Nationwide Mutual Fire Insurance Company
Sentry Insurance A Mutual Company

Utica Mutual Insurance Company
West Bend Mutual Insurance Company

Subsidiaries of Mutual Insurance Companies

The following Petitioners are wholly-owned subsidiaries of mutual insurance companies, as indicated below. As mutual insurance companies, the parent corporations of these Petitioners have no stock outstanding:

Petitioner American Standard Insurance Company of Wisconsin is a wholly-owned subsidiary of American Family Mutual Insurance Company.

Petitioner CUMIS Insurance Society, Inc. is a wholly-owned subsidiary of CUNA Mutual Insurance Society.

The following Petitioners are wholly-owned subsidiaries of Liberty Mutual Holding Company, Inc.:

Albany Insurance Company
Atlas Assurance Company of America
Liberty Insurance Corporation
Liberty Mutual Insurance Company
Wausau Underwriters Insurance Co.

Petitioner Liberty Life Assurance Corporation of Boston is owned 90% by Liberty Mutual Holding Company, Inc. and 10% by Liberty Mutual Fire Insurance Company.

The following Petitioners are wholly-owned subsidiaries of Nationwide Mutual Insurance Co.:

National Casualty Company
Nationwide General Insurance Company
Nationwide Life Insurance Company
Nationwide Property & Casualty Insurance Company

Petitioner Owners Insurance Company is a wholly-owned subsidiary of Auto-Owners Insurance Company.

The following Petitioners are wholly-owned subsidiaries of Sentry Insurance A Mutual Company:

Dairyland Insurance Company
Sentry Life Insurance Company